Government
and the
American Economy

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New York
W · W · NORTON & COMPANY · INC ·
Publishers

PRINTED IN THE UNITED STATES OF AMERICA
FOR THE PUBLISHERS BY THE VAIL-BALLOU PRESS

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Preface

This book presents an examination and analysis of one of the profoundly important developments of the last half century—the assumption by government of major responsibilities for the guidance and direction of the American economy. From a comparatively passive role devoted primarily to "holding the ring" for individual enterprise, government has come to exercise an active influence upon every phase of economic activity. While this trend has been vastly accelerated by the events of the last decade, it was clearly discernible before the Great Depression of 1929. Its root causes lie deeply embedded in the technological, economic, and social transformations induced by the Industrial Revolution and the democratic movement of the nineteenth century. The energies released by modern industrialism and democracy have given shape and content to the multiplying obligations of government in the economic realm.

The emphasis here is on the political forces which influence the formation and execution of public policy. This emphasis is based on the conviction that effective economic or other criteria of desirable public policy can be most fruitfully developed when there is a vivid realization of the potentialities and limitations of the political context in which they must be applied. Our approach does not mean that economic analysis is neglected. Every effort has been made to take account of economic as well as political, legal, and administrative factors which enter into the determination of public economic policies.

The arrangement of the material has presented serious problems. The actions taken by government in the economic sphere do not lend themselves to classification in neat and mutually independent categories. The organization here adopted has been selected primarily with a view to convenience of exposition. Part I presents the salient

features of the economic background out of which demands for government intervention have arisen, the organization of the basic economic interest groups which seek to determine the content of public policy, and the legal and constitutional framework within which the struggles and accommodations of interest groups take place. Part II deals with governmental activities designed primarily to give positive aid to particular economic interests. Such activity is often intermingled with government regulation, which is treated in Part III. In its historical development, regulation has begun in a negative fashion by seeking to eliminate particularly objectionable practices and abuses which have been deemed harmful to the public interest. Later, it has been extended more positively, in an effort to guide the development of an industry and to adjust its relationships to the economy as a whole. Part IV is concerned with the direct participation of government in economic life through public enterprise and with government's responsibilities for the conservation of natural and human resources.

We are aware that there are inevitable overlappings among such categories and that particular activities might well be classified under two, or even three, of our headings. Thus, the promotion of business, agricultural, labor, or consumer interests may also take the form of regulatory restraints upon other economic groups. Similarly, in the case of such distressed industries as railroads and bituminous coal, regulation may frequently be merged with promotional objectives. Government activities in public enterprise or in conservation may also involve incidental regulatory or promotional purposes. We have sought throughout, however, to arrange the material in accordance with the dominant characteristics of each activity.

To publish a book on *Government and the American Economy* at this time presents peculiar hazards. The uncertainties of international developments are reflected in a rapidly shifting picture of domestic controls. While we have indicated the major repercussions of the defense program on peacetime policies up to the end of 1940, we have made no systematic effort to present the developing picture of emergency controls. If circumstances permit, we hope to take account of this rapidly developing field in a future edition of this work.

Our attention has been centered primarily upon the American scene. In some parts of the presentation, however, we have felt that foreign experience illuminates the problems facing American public policy. In such areas, of which public enterprise is the outstanding

example, we have not hesitated to explore developments abroad in some detail.

The planning of the book and the entire writing process have been carried on in close collaboration between the two authors. Each author, however, has prepared the initial drafts of particular chapters and is primarily responsible for their contents. Mr. Fainsod undertook the preparation of Chapters 1, 2, 4, 5, 8, 9, 10, 11, 12, and 21, and Mr. Gordon of Chapters 3, 7, 13, 14, 15, 16, 17, 18, 19, and 20. Chapters 6 and 22 were written jointly by the two authors.

We are heavily indebted to Professors W. Y. Elliott and C. J. Friedrich, who have been particularly helpful in the planning of this volume, and to others of our colleagues in the Departments of Government and Economics with whom we have from time to time discussed portions of its contents. We also wish to extend our most sincere appreciation to Mr. A. C. Burnham, of W. W. Norton and Company, for his cordial co-operation and valuable suggestions at every stage of the book's preparation, and to Mrs. Marion E. Lydenberg and Miss Evelyn Sternberg, for their admirable secretarial assistance in the preparation of the manuscript.

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March, 1941

Acknowledgments

We are very happy to express our appreciation to the following for permission to reproduce passages from the indicated works:

To the American Economic Association for material from W. H. S. Stevens, "The Trade Commission Act," *American Economic Review,* Volume 4.

To the Brookings Institution for material from H. G. Moulton, *The American Transportation Problem.*

To the *Columbia Law Review* for material from Volume 32.

To the Columbia University Press and the author for material from E. G. Campbell, *The Reorganization of the American Railroad System 1893–1900;* and for material from H. C. Mansfield, *The Lake Cargo Coal Rate Controversy.*

To the Commerce Clearing House, Inc., for material from M. Handler, *The Federal Antitrust Laws, A Symposium.*

To the Commonwealth Fund for material from I. L. Sharfman, *The Interstate Commerce Commission.*

To the Duke University School of Law for material from J. G. Maddox, "Bankhead-Jones Farm Tenant Act," *Law and Contemporary Problems,* Volume 4.

To the Foundation Press, Inc., for material from E. C. Goddard, "The Evolution and Devolution of Public Utility Law," *Selected Essays in Constitutional Law.*

To the *George Washington Law Review* for material from C. S. Rhyne, "Work of the Interstate Commerce Commission in Railroad Reorganization Proceedings under Section 77 of the Bankruptcy Act," in Volume 5.

To Harper and Brothers for material from P. A. Odegard and E. A. Helms, *American Politics;* and to Harper and Brothers and

Mrs. Woodrow Wilson for material from *The Public Papers of Woodrow Wilson.*

To the Harvard Law Review Association and the author for material from Northcutt Ely, "The Conservation of Oil," *Harvard Law Review,* Volume 51.

To the Harvard University Press for material from S. J. Buck, *The Granger Movement,* and E. M. Dodd, "The First Half Century of Statutory Regulation of Business Corporations in Massachusetts," *Harvard Legal Essays.*

To Henry Holt and Company for material from S. H. Slichter, *Modern Economic Society.*

To Houghton Mifflin Company for material from A. J. Beveridge, *The Life of John Marshall,* and G. B. Clarkson, *Industrial America in the World War.*

To Longmans, Green & Co., Inc., for material from W. Z. Ripley, *Railroads: Rates and Regulation.*

To the McGraw-Hill Book Company, Inc., for material from A. R. Burns, *The Decline of Competition.*

To the *Missouri Law Review* for material from H. N. Monkemeyer, "Five Years of the Norris-La Guardia Act," in Volume 2.

To the Principia Corporation, Elsah, Illinois, for material from an address by Mr. Gordon at the Second Annual Public Affairs Conference on "The Citizen and His Government" at the Principia College, May, 1940.

To the *Public Opinion Quarterly, Inc.,* for material in Volume 1 from G. Griswold, "Public Relations—Some Misconceptions"; J. L. Lewis, "What Labor is Thinking"; and N. E. Long, "Public Relations of the Bell System."

To G. P. Putnam's Sons for material from L. A. Coolidge, *An Old Fashioned Senator: O. H. Platt.*

To Random House, Inc., for material from *The Public Papers and Addresses of Franklin D. Roosevelt.*

To Charles Scribner's Sons and the author for material from E. R. Abrams, *Power in Transition.*

To Simon and Schuster, Inc., for material from L. M. Hacker, *The Triumph of American Capitalism.*

To Miss Helen Sorenson for material from her unpublished doctoral dissertation at Radcliffe College, entitled, "An Economic Interpretation of the Consumer Movement."

To the Twentieth Century Fund for material from *The Security Markets.*

To the University of Chicago Press for material from L. D. White, "The Origin of Utility Commissions in Massachusetts," *Journal of Political Economy,* Volume 29.

To the Viking Press, Inc., for material from T. Veblen, *Absentee Ownership and Business Enterprise.*

To the *Wisconsin Law Review* for material from R. S. Ely, "The Work of the Federal Trade Commission," Volume 7.

To the Yale University Press for material from E. S. Corwin, *The Twilight of the Supreme Court,* and J. M. Landis, *The Administrative Process.*

Part I

THE AMERICAN SETTING

Chapter One. THE ECONOMIC BACKGROUND

Governments function in an economic context. They adopt policies which both reflect and shape the economic context in which they function. The nature of the economic policies which they adopt varies greatly with time and place and circumstance.

In 1790, a year after George Washington was inaugurated as the first President of the United States, the annual expenditures of the federal government totaled $4,200,000. Its functions were narrowly limited. The conduct of foreign affairs, national defense, law enforcement, tax collection and tariff administration, the postal service, the mint, banking, patents, land grants, pensions, Indian affairs—these constituted the chief areas where the federal government touched the lives and economic activities of its people.

One hundred years later, ten years before the turn of the century, the annual expenditures of the federal government had mounted to $318,000,000. Its functions were still relatively circumscribed. The burden of governmental business had increased with the growth in population, but the bulk of federal activity still fell within the traditional and familiar lines marked out in the seventeen-nineties. But already harbingers of a more spacious conception of the role of government were in evidence. In 1887 the Interstate Commerce Commission was established, the first of a long line of federal regulatory commissions. Three years later came the enactment of the Sherman Antitrust Act.

Since 1890 the expansion of the economic powers of the federal government has proceeded at a steadily accelerating pace. The barest inventory of contemporary federal government activity reveals the direction of the growth. What was formerly a government limited in its assumption of responsibilities and peripheral in its effects has

become intimately intertwined with the economic life of the nation. Labor has invoked the assistance of government in guaranteeing collective bargaining, in maintaining minimum labor standards, and in securing protection against the ravages of unemployment. Farmers have sought and obtained large-scale federal aid for agriculture. The widening regulatory activities of government have reached far beyond the original area staked out for the Interstate Commerce Commission in 1887. Transportation, communications, electrical and gas utilities, the securities exchanges, packers and stockyards, commodity exchanges, the alcohol industry, the bituminous coal industry, the oil industry, and the milk business have all been subjected to special regulatory regimes. Banking and currency controls have been strengthened; a host of federal lending agencies have sprung up and made a decisive impact in areas as diverse as agricultural credit, urban real estate credit, railroad finance, and public works. The federal government has greatly broadened its activities in the fields of conservation of natural resources and social welfare. Under the stimulus of new urgencies a heavy burden of new responsibilities has been assumed.

Major economic transformations have contributed to this tremendous growth in the economic activities of government. In a very real sense, the expanding functions of government are a product of industrialization and its economic consequences.

1. The Rise of Modern Industry in the United States

The rise of modern industry in the United States is essentially a post-Civil War phenomenon. Pre-Civil War America was still predominantly an agrarian society. In 1860 only 16.1 per cent of the total population resided in places with eight thousand or more inhabitants. Business units were small, and were usually owned by individuals or small groups of persons. The man of business was typically a merchant or banker rather than an industrialist. Business enterprise found its outlets, for the most part, in trade, in banking, in land speculation, in mining, and in transportation ventures such as canals, bridges, turnpikes, and, later, railroads. Industrial production was small and was still predominantly of the cottage and mill type. Articles were fabricated by small independent producers and purchased by merchants or commission men who moved them into channels of commerce. Sometimes the merchant supplied the material, equip-

ment, or credit, and thus extended his control over the productive process. The typical workman was still the skilled artisan, craftsman, or journeyman apprentice. The modern factory system with its automatic machinery, standardized products, rationalization of operations, and wage labor was just beginning to make its appearance. It developed early in cotton textiles in New England and by 1850 it was beginning to spread to the manufacture of iron, machinery, and leather products. But, by and large, the factory system was still relatively unimportant.

Beginning about 1850, and accelerating with the Civil War, industrialization proceeded at a rapid tempo. The following table reveals the spectacular growth of manufacturing in the years between 1850 and 1880.[1] As this table indicates, the capital invested in manufacturing and the value of products turned out increased more than 400 per cent over the thirty-year period. The performance of heavy

GROWTH OF MANUFACTURES IN THE UNITED STATES

1850–1880

1. Growth of Manufactures in the United States
(Figures of value in millions of dollars)

Items	*1850*	*1860*	*1870*	*1880*
Capital invested	533.2	1009.9	1694.6	2790.3
Value of products	1019.	1885.	3386.	5369.6

2. Per Cent Increases

Items	*1850–60*	*1860–70*	*1870–80*	*1850–80*
Capital invested	89.4	67.8	64.7	423.5
Value of products	85.	79.5	58.6	426.9

3. Value of Products of Selected Light Industries
(Figures in millions of dollars)

Industries	*1850*	*1860*	*1870*	*1880*
Cotton manufactures	61.9	115.7	142.	192.1
Woolen manufactures	48.6	73.5	159.4	238.1
Boots and shoes	54.	91.9	145.3	196.9
Men's ready-made clothing	48.3	80.8	118.9	209.5

[1] This table is adapted from Louis M. Hacker, *The Triumph of American Capitalism* (1940), Appendix A, pp. 437–438.

4. Per Cent Increases

Industries	*1850–60*	*1860–70*	*1870–80*	*1850–80*
Cotton manufactures	87.	22.7	35.3	210.5
Woolen manufactures	51.1	117.	49.4	389.8
Boots and shoes	70.3	58.1	35.5	264.9
Men's ready-made clothing	67.3	47.1	76.2	333.7

5. Value of Products of Selected Heavy Industries
(Figures in millions of dollars)

Industries	*1850*	*1860*	*1870*	*1880*
Pig iron	12.7	20.9	55.7	89.3
Agricultural implements	6.8	20.8	41.7	68.6
Machinery	28.	51.9	110.8	214.4
Lumber	60.4	96.7	168.1	233.3
Clay products	8.2	14.	29.1	41.8

6. Per Cent Increases

Industries	*1850–60*	*1860–70*	*1870–80*	*1850–80*
Pig iron	63.7	166.9	60.3	600.6
Agricultural implements	204.5	99.9	64.8	903.2
Machinery	85.3	113.6	93.5	665.6
Lumber	60.1	73.8	38.7	286.1
Clay products	70.8	108.	43.8	410.6

industry was particularly striking. The value of products turned out by the agricultural implements industry increased more than 900 per cent, by the machinery industry slightly more than 665 per cent, and by the pig-iron industry approximately 600 per cent.

The explanation for this extraordinary growth was many sided. Natural resources such as coal, oil, iron, lumber, lead, copper, silver, and gold existed in great profusion. Railroad construction widened the domestic market, opened up new areas for settlement, and was itself a "prime mover" in stimulating demand for coal and iron. Population growth was accelerated by an influx of immigration. The supply of labor was abundant. Entrepreneurial initiative was vigorous. The tariff on many manufactured products provided protection against foreign competition. And perhaps most important of all, technological advances in transportation and industry and increasing mechanization of industrial processes opened the way to mass production, increased labor productivity, and large-scale economic

organization.[2] Agriculture, too, was undergoing a process of mechanization and expansion; the increasing emphasis on cash crops helped to provide export balances to offset the import of capital which was furthering industry growth.

2. The Corporate Revolution

Starting in the seventies, the impact of these far-reaching changes began to reshape the organization of American economic life. The prevailing individualistic and competitive system began to give way to a corporate and monopolistic, or quasi-monopolistic, system. The corporation, originally merely a convenient instrument for the enlargement of the scope of business enterprise, was soon to reveal itself, in Veblen's phrase, as the "master institution of civilized life."[3]

One manifestation of these changes was a vast increase in the size of business units. The corporation frequently provided the instrument by which this was achieved. Before the Civil War the use of the corporate form in the industrial field was confined almost entirely to the textile industry. With the burst of industrial expansion after the Civil War, the corporate form of doing business spread rapidly to other sectors of economic life as the advantages which it offered in the way of limited liability and pooling investment became apparent. But many manufacturing enterprises, to begin with, continued to be closely held; there was little or no resort to the

[2] David A. Wells, writing in 1889 on *Recent Economic Changes* (pp. 64–65), noted the following "inventions, discoveries, and applications" already in use:

"The mechanical reapers, mowing and seeding machines, the steamplow and most other eminently labor-saving agricultural devices; the Bessemer process and the steel rail (1857); the submarine and transoceanic telegraph cables (1866); photography and all its adjuncts; electroplating and the electrotype; the steamhammer, repeating and breech-loading firearms and rifled and steel cannon; gun-cotton and dynamite; the industrial use of India-rubber and gutta-percha; the steam excavator and steam-drill; the sewing machine; the practical use of the electric light; the application of dynamic electricity as a motor for machinery; the steam fire-engine; the telephone, microphone, spectroscope, and the process of spectral analysis; the polariscope; the compound steam-engine; the centrifugal process of refining sugar; the rotary printing press; hydraulic lifts, cranes and elevators; the 'regenerative' furnace, iron and steel ships, pressed glass, wire rope, petroleum and its derivatives and analine dyes; the industrial use of the metal nickel, cotton-seed oil, artificial butter, stearine-candles, natural gas, cheap postage and the postage stamp. . . ." Cited in Hacker, *op. cit.*, p. 403.

[3] T. Veblen, *Absentee Ownership and Business Enterprise* (1923), p. 86.

money markets to obtain funds; expansion was financed, for the most part, by plowing earnings back into the business. The early history of the Carnegie and Rockefeller enterprises illustrates this type of development.

Large-scale economic enterprise offered many undoubted economic advantages. It utilized new technical processes and machinery to attain the economies of specialization and division of labor. It organized quantity production and lowered unit costs. It frequently offered economies in purchasing and distribution. It made possible greater productivity and opened the way to a higher standard of living and increased leisure for the masses.

With increases in size, however, came also increasing concentration of control in many industries. In the first phases of the combination movement, industrialists themselves supplied the driving force. A variety of techniques was employed. Sometimes, competitors merged or were bought out. Sometimes, they were driven out of business by ruthless competition. The more powerful companies expanded their operations. Thus, Carnegie moved in the direction of vertical integration by combining ownership of coal deposits, coke ovens, iron mines, and transportation facilities with manufacture of iron and steel. Standard Oil followed a policy of horizontal integration by combining refineries and controlling pipe lines; its dominant position in these two fields made it unnecessary to acquire ownership rights in the oil fields themselves. Discriminations in railroad rates played a major role in advancing industrial concentration. Both Carnegie and Standard Oil, particularly the latter, benefited from extensive railroad rebates, which gave them a marked advantage over their competitors. In some instances, pools were formed to regulate price and output; but since individual members of these pools retained a large degree of independence, conflicting interests usually led to nonobservance and dissolution of the agreements. After 1880, the "trust" method of combination became the fashion, following the lead of the Standard Oil Trust established in 1879. When the "trust" agreement proved vulnerable to legal attack, it was replaced by the holding company. New Jersey modified its general corporation laws in 1889 to permit corporations to hold stock in other corporations. Other states quickly followed suit, and the process of industrial concentration marched inexorably onward, though not without resistance. Agrarian and small business discontent expressed itself in a series of state measures directed against the railroads and

the trusts and in the enactment of the federal Interstate Commerce Act of 1887 and the Sherman Antitrust Act of 1890, but without marked effect in checking the concentration movement itself.

Beginning in the eighteen-eighties and eighteen-nineties, a new force emerged to give shape and direction to the combination movement. That force was the rising power of the investment banker. Industry needed funds to enlarge its operations. The function of the investment banker was to supply these funds by mobilizing accumulated savings through the sale of stocks or bonds and directing them into profitable channels of investment. But the activities of investment bankers soon extended far beyond this middleman function. Operations were expanded to gain and consolidate control over both the supply of, and the demand for, credit. In order to control investment funds and to guarantee credit facilities needed in marketing securities, interlocking relationships were developed with insurance companies, commercial banks, and trust companies. At the same time, the furnishing of funds to industry was used as a strategic lever to enlarge banking influence over industry. The leadership taken by the House of Morgan in the financial reorganization of the railroads during the nineties made that firm a major power in the railroad field. From railroads, Morgan and Company moved into industrial financing, particularly into steel. The acquisition of the Carnegie properties and the organization of the billion-dollar United States Steel Corporation, with Morgan interests dominating the directorate, became a dramatic symbol of the growing subordination of industry to finance. Between 1898 and 1902, mergers and consolidations followed each other in rapid succession with investment bankers performing the midwifely function. After 1902 the pace of consolidation slackened, only to revive again in a great burst of activity during the twenties. Thus, financial concentration became the instrument by which industrial concentration was frequently achieved and accelerated. But there were notable exceptions, areas where investment bankers did not penetrate. Ford, to give only a single example, maintained his independence and was able to build a vast enterprise out of his own internal resources.

Significant shifts in the locus of economic control attended this growth of large-scale corporate enterprise. To understand the direction of development, it is necessary to go back and visualize a typical entrepreneur of the precapitalistic era. He did his own work, owned his own tools, supplied his own capital, and managed and controlled

his own enterprise. There was a concentration of functions. With the development of the industrial and corporate revolution, this concentration began to break up. The first step was the separation of labor from ownership. The worker no longer controlled the enterprise. He hired out for wages; the employer owned the factory and the expensive machinery which it contained. This divorce of labor from ownership inspired the Marxian theory of class war, and other more or less socialistic doctrines. Marx called for proletarian organization as the means of collectivizing ownership. Workers, however, turned, for the most part, to other means of restoring a degree of control, chiefly through trade-unions and collective bargaining.

The next phase in the dynamics of corporate development was the separation of management from ownership. Thorstein Veblen was among the first to call attention to this development. In an important and (at the time) little appreciated work, *Absentee Ownership and Business Enterprise,* he pointed to the rise of absentee ownership as a significant aspect of the growth of large corporations. Where formerly owners of enterprises also managed them, Veblen now saw the emergence of a separate managerial group—the administrators—who were hired like workers to perform the function of management.

In the course of the further development of the corporate system, as Berle and Means have pointed out,[4] ownership itself became separated from control. With the dispersion of stock ownership and the perfection of old and new legal devices such as the proxy, the pyramided holding company, the issuance of nonvoting stock, and the vesting of disproportionate power in one class of stock, new concentration of power emerged in the form of so-called "control groups," which owned only a small percentage of the corporate assets but at the same time were able to dominate corporate policy, determine its strategy, and direct the disposition of the corporate income stream. The general body of average stockholders was thus reduced to the status of investors only, disfranchised as far as power over policy was concerned, no longer working in or managing the enterprises in which their savings were invested, dependent ultimately on the decisions of the control groups for such income as they received. The ultimate control over business policy and industrial processes thus came to be centered in the hands of relatively small groups of men,

[4] A. A. Berle and G. C. Means, *The Modern Corporation and Private Property* (1933).

sometimes a management group, sometimes a combination of management and banking groups, sometimes primarily a banking group, but in most cases groups operating, in large part, with what Justice Brandeis once called "Other People's Money."

The implications of these developments form an important part of the institutional setting for government activity in the economic realm. As a result of the corporate revolution, traditional notions of private property required modification and rethinking. Property, from something corporeal and tangible, has become incorporeal and intangible, a bundle of expectations, interests, controls, and relationships. With the separation of ownership from control, as Justice Brandeis has pointed out, "many of the checks which formerly operated to curb the misuse of wealth and power" have been moved. That "control groups" may regard their position as one of trusteeship and impose high standards of responsibility upon themselves there is experience to verify. But there is also experience to indicate that "control groups" have frequently regarded their own entrenched position as absolute and have behaved as if their only obligation were their own self-enrichment. Concentration of power in the hands of such groups raises important problems. It leaves consumers, investors, labor, and farmers with minimum control over industrial activity despite their great and basic interests in it. Out of this situation, as we shall see, have arisen many of the pressures for government to intervene—pressure to protect investors, pressure to protect labor, pressure to protect farmers, and pressure to protect consumers.

3. Recent Economic Developments

THE "PROSPERITY" OF THE TWENTIES

Prior to 1929, the accent was still on industrial expansion. Between 1899 and 1929, the value of the product of manufacturing industries in the United States multiplied about six and one-half times.[5] Cyclical maladjustments occurred as in 1903, 1907, 1914, and 1921, but the secular trend was definitely upwards. During the twenties, industrial and residential building reached a new high, drawing on the backlog caused by the virtual cessation of housebuilding during the war and by the intervening growth of population. The automobile industry forged rapidly ahead, carrying with it such related industries as rubber, oil, glass, steel, and road building. There was a

[5] Temporary National Economic Committee, *Hearings*, Vol. I (1939), p. 129.

large volume of public construction, such as roads, schools, and other improvements, financed largely by state and local borrowing. Consumer credit expanded and stimulated purchasing power. Foreign loans and investments served to finance exports. By 1929, the physical volume of industrial production was more than 25 per cent above the level of 1922 [6] and the stock market registered wild optimism.

But, for the thoughtful, there were many disquieting elements in the "prosperity" of the twenties. Though industrial production increased, the rate of growth showed evidences of decline when compared with previous periods. The rate of population growth was also decreasing. Agriculture did not share in the general "prosperity." With the collapse of the war boom, foreign demand for American farm products declined sharply, while production continued at former high levels. As agricultural prices fell, the farmer's purchasing power contracted. A growing discrepancy developed between the prices of agricultural and manufacturing products, and a rumbling undertone of agrarian discontent introduced a note of dissonance into the paeans to the New Era. There were "sick" industries, such as textiles and bituminous coal. The position of labor, too, was by no means satisfactory. In the depression of 1921, the number of unemployed rose to 5,500,000, and even at the height of industrial activity in 1929 it was estimated that 2,000,000 persons were out of work. The Brookings Institution's studies showed that in 1929 nearly 6,000,000 families, or 21 per cent of the total, had family incomes of less than $1,000 annually.[7] While the index of industrial production rose, total employment in manufacturing industries remained substantially the same.[8] Real wages of employed workers increased, but in no sense proportionately to profits and dividends.[9] At the same time, artificial and necessarily impermanent stimulants operated to create the illusion of widespread prosperity. The expansion of installment selling and consumer credit, the export of American capital to subsidize foreign consumption of American goods, and the paper profits generated by a rising stock market, all served as engines to inflate purchasing power and to increase consumption.

[6] *Ibid.*, p. 27.

[7] M. Leven, H. G. Moulton, and C. Warburton, *America's Capacity to Consume* (1934), p. 54.

[8] See T.N.E.C. *Hearings*, Part I (1939), p. 45.

[9] *Ibid.*, pp. 196, 197.

THE DEPRESSION

With the collapse of the stock market in October, 1929, a spiral of deflation set in. The depression took on catastrophic proportions. National income declined from $81,100,000,000 in 1929 to $40,000,000,000 in 1932, salaries and wages paid fell from $49,200,000,000 to $29,941,000,000, dividend payments from $6,000,000,000 to $2,700,000,000, gross farm income from $12,000,000,000 to $5,300,000,000.[10] The index of physical volume of production dropped from 125 in June, 1929, to 59 in March, 1933.[11] Foreign commerce was reduced from slightly less than $5,500,000,000 to approximately $1,750,000,000 in the same period. As a result, many businesses and banks went to the wall, thirteen to fifteen million persons became unemployed, homes and savings were lost, thousands of farmers lost their farms through foreclosures, and other thousands were threatened with foreclosure.

The record of efforts to cope with the depression is instructive. With the demoralization of the stock market, the methods of 1907 were resurrected and a bankers' pool was organized to check the decline. It proved powerless to withstand the magnitude of the liquidation. President Hoover next appealed for business as usual, but his appeals fell on deaf ears. As purchasing power fell off, wages were reduced and workers dismissed, and thus a further impetus was given to the downward spiral. In many industrial areas dominated by large-scale corporate enterprise, prices fell little as compared with the prices of agricultural commodities. Thus, as Gardiner Means has shown,[12] between 1929 and 1933:

Prices	of	agricultural commodities	fell	63%;	production	fell	6%;
"	"	iron and steel	"	20%;	"	"	83%;
"	"	cement	"	18%;	"	"	65%;
"	"	motor vehicles	"	16%;	"	"	80%;
"	"	agricultural implements	"	6%;	"	"	80%.

This disparity in response to depression accentuated the maladjustment in agriculture and other flexible price areas.

As the depression deepened, and its dislocations threatened to undermine the entire business, banking and credit structure, the pressure for governmental intervention became irresistible. Much of this

[10] *Ibid.*, p. 194.

[11] *Ibid.*, p. 201.

[12] G. C. Means, *Industrial Prices and Their Relative Inflexibility* (1935), S. Doc. 13, 74th Cong., 1st Sess. (1935).

demand came from leading businessmen; it was largely in response to such demand that the Reconstruction Finance Corporation was organized in 1932 and its resources made available to banks, businesses, insurance companies, and railroads which were threatened with insolvency. While direct aid to business formed a primary element in Hoover's program for ending the depression, the pressure of circumstances forced a wider attack. Under Hoover, the Federal Farm Board expended large sums in what turned out to be vain efforts to stabilize the price of agricultural commodities. Other emergency credit facilities were made available to farmers. An ambitious public works program was undertaken. For the first time unemployment relief was placed on a federal basis.

DEVELOPMENTS UNDER THE NEW DEAL

What President Hoover began, the New Deal continued on a much vaster scale and with different emphasis. The Reconstruction Finance Corporation widened its activities. Emergency salvaging operations were extended into other fields. Public credit was used to prevent farm and home foreclosures, to provide relief for the unemployed, and to finance public works. The New Deal evidenced a new sensitivity to the claims of labor, farmers, and other disadvantaged groups. A host of new regulatory controls appeared in response to such demands. There was a vast expansion of social welfare activities—relief, housing, and social security. Public expenditures and public enterprise played a new and significant role in the total economy. All during the twenties the government contribution to total income-producing expenditures had been small; the major contributions were made by the private sector of the economy. With the onset of depression the trend was reversed; while private income-producing expenditures fell off sharply, the government proportion increased greatly, accounting for over one-third of the total expenditures for the period 1930–38. This included the year 1937, when a combination of decreased expenditures for relief and public works and increases in taxation, notably the Social Security Tax, accounted for a sharp drop in the government contribution, to only 5.2 per cent.[13]

[13] T.N.E.C. *Hearings*, Part 9, *Savings and Investment*, p. 4122. By income-producing expenditures are meant expenditures which represent a net addition to the cash income of the community. These expenditures offset savings which are withdrawn from the income stream.

Meanwhile, the national income climbed from $40,000,000,000 in 1932 to over $70,000,000,000 in 1937, only to fall off again in 1938 to $63,610,000,000, and to recover to nearly $70,000,000,000 in 1939, with a revival of public expenditures. Particularly significant in the record of these years is the extent to which public borrowing, deficit dynamics, public banking, and public enterprise took over the function formerly performed by private entrepreneurial dynamics. Savings continued at a high level, but private enterprise could not find adequate investment outlets for these savings. No new "prime mover" appeared to play the role which the railroads had discharged in the post-Civil War years, or which the automobile industry had enacted during the twenties. The rate of population growth continued to decline and was attended by a low rate of residential and commercial construction. Capital outlays on railroads and public utilities dropped sharply, compared with the twenties, and the loss of foreign trade was also felt in many areas of the economy. In March, 1937, at the height of the first New Deal recovery, the index of physical volume of industrial production reached 118, compared with the 1929 high of 125, but fell again to 76 in May, 1938, from which it began a new climb upwards.[14] Meanwhile, it was estimated that seven and one-half million persons were still unemployed in 1937, and in the ensuing decline in 1938 this total increased to nearly eleven million, eight hundred thousand.[15]

The recent heavy increase in national defense appropriations only serves to accentuate the important role of governmental expenditures in the total economy. Total expenditures of the federal government for the fiscal year 1940–41 will approximate twelve billion dollars; preliminary estimates for the fiscal year 1941–42 indicate expenditures of over twenty-two billions. Almost all of the increase probably will be accounted for by national defense; as the country moves into an arms economy, the proportion of social welfare expenditures dwindles. New capital expansion will be guided largely by defense needs and will take the form of expenditures for aircraft facilities, powder plants, shipyards, power facilities, and related projects, most of them financed, significantly, through governmental channels. The stimulus of arms spending has already communicated itself to important sectors of the economy, particularly to the heavy industries ministering to war needs. Meanwhile, national in-

[14] T.N.E.C. *Hearings,* Part I (1934), p. 201.
[15] *Ibid.,* p. 160.

come rises and unemployment decreases. On the other hand, farmers, particularly those growing export crops, are apt to benefit little, and to continue dependent on government payments to compensate for the loss of important foreign markets.

4. Basic Characteristics of the American Economy

While it is impossible at the present time to anticipate either the volume or the duration of arms spending, or to appraise its future impact upon the economy, it may still be useful to summarize some of the basic characteristics of the economy upon which it is being superimposed. To do so is at least to indicate the context out of which present-day controls have emerged and with which they seek to cope.

In the first place, it is an economy characterized by considerable unevenness in distribution of income. According to the National Resources Committee study of the Distribution of Consumer Income in the United States in 1935–36,[16] more than 6,700,000 families and single individuals, or 17.01 per cent of the total, had annual incomes of $500 or less; more than 18,400,000, or 46.54 per cent of the total, had incomes of $1,000 or less; approximately 32,000,000, or 81.82 per cent of the total, had annual incomes of $2,000 or less. The somewhat less than 18,500 families and single individuals with annual incomes of $50,000 or over had approximately the same aggregate income as the 6,700,000 families with annual incomes of $500 or less. The 177,600 families and individuals with annual incomes of $15,000 or over had approximately the same aggregate income as the 12,600,000 families and individuals with annual incomes of $750 or less. The existence of these disparities is a fact of major significance. An economy geared for mass production finds itself with large segments of the population without the wherewithal to purchase its potential output.

In the second place, it is an economy dominated on its industrial side by large-scale enterprise. Of the 1,730,000 employers covered by the Social Security Board records in 1937, 50 per cent of the employers, each one accounting for three or less employees, employed approximately 4 per cent of the workers. Seventy-six per cent of the employers, each one accounting for nine or less employees, employed

[16] See *Statistical Abstract of the United States* (1939), p. 313.

only 11 per cent of the workers. At the other end of the scale, 1 per cent of the employers, each one accounting for 250 or more employees, employed 50 per cent of the workers. One hundred and ninety-five enterprises, approximately one one-hundredth of 1 per cent of the employer total, each enterprise employing 10,000 or more employees, accounted for 12.3 per cent of all workers.[17] The following table [18] indicates the importance of large-scale enterprise in four significant sectors of the economy:

Activity	*Percentage of total corporate assets accounted for by corporations with assets of $5,000,000 or more*	*Percentage of industry activity accounted for by corporations*
Transportation and public utilities	92.7%	92%
Manufacturing	65.8%	92%
Mining and Quarrying	64.8%	96%
Finance	77.7%	84%

As this table reveals, industry and finance are dominated by large-scale enterprise. On the other hand, small business units are much more important in agriculture, retail trade, construction, and the service occupations.

In the third place, the economy is characterized by considerable concentration of control, with control particularly marked in certain areas. In 1929, according to the National Resources Committee, the two hundred largest nonfinancial corporations and their subsidiaries controlled 47.9 per cent of the assets of all nonfinancial corporations. By 1933, this proportion had increased to over 54 per cent.[19] The degree of control varies in different sectors and is not always a concomitant of size. The following table stresses concentration of control of output: [20]

[17] T.N.E.C. *Hearings,* Vol. I, pp. 99, 229 (1939).

[18] Table adapted from data in *ibid.,* pp. 108, 230.

[19] National Resources Committee, *The Structure of the American Economy* (1939), Part I, p. 107.

[20] This table is adapted from testimony before the T.N.E.C., Part 1, *Economic Prologue,* p. 137.

Product	*Number of companies*	*Per cent of output produced*	*Authority*
Aluminum	1	100	Federal Trade Commission (1937)
Automobiles	3	86	Department of Commerce (1937)
Beef products	2	47	Federal Trade Commission (1935)
Cans	3	90	Federal Trade Commission
Cement	5	40	Federal Trade Commission (1931)
Cigarettes	3	80	Federal Trade Commission (1934)
Copper	4	78	Bureau of Mines (1935)
Corn binders	4	100	Federal Trade Commission (1936)
Corn planters	6	91	Federal Trade Commission (1936)
Iron ore	4	64	Bureau of Mines (1935)
Plate glass	2	95	Tariff Commission (1935)
Safety glass	2	90	Tariff Commission (1935)
Steel	3	60.5 *	Tariff Commission (1935)
Whiskey	4	58	Federal Alcohol Authority (1937–38)
Zinc	4	43	Bureau of Mines (1935)

(* Steel percentage represents capacity, not output.)

As this table indicates, in only one industry, the aluminum industry, does a single company completely dominate the industry. The characteristic pattern disclosed in the above table is that of a small group of enterprises, which together are able to control a large, and sometimes an overwhelming, proportion of the industrial output of a particular industry.

The consequences of this concentration are revealed in a fourth characteristic of the economy, the decline of competition in many areas. In industries, such as those listed in the above table, prices are no longer determined altogether by the impersonal forces of supply and demand. Producers are in a position to influence price; prices become, in Gardiner Means's phrase, administered prices rather than market prices. Price control may assert itself in a variety of forms: by following the price leadership of a particular firm; by dividing or sharing the market; by price discrimination; by reducing output and employment rather than price in the face of declining demand; by the submission of identical bids; and by other forms of price behavior which indicate administrative co-ordination rather than coordination through the market place. The existence of a high degree of price control in some sectors of the economy and its absence in

others tends to create serious problems of adjustment, as the example cited earlier of the relation of agriculture and industrial prices between 1929 and 1933 indicated. Disparities in the degree of price control exercised accentuate the effective bargaining power of the organized sector of the economy as against the unorganized; they also inspire counterorganization among the unorganized and efforts to utilize the instrumentalities of government to strengthen the bargaining power of weaker economic interests.

This emerging trend, which has run particularly strong in recent years, points to a fifth characteristic of the economy, the organization of hitherto little organized groups for effective economic action. The spread of trade associations, labor organizations, producers' co-operatives in the agricultural field, and consumers' co-operatives evidences the strength of this tendency in diverse fields. Particularly significant has been the recent invocation of governmental authority to buttress the bargaining power of some of these groups. Small independent firms, particularly in distribution, have sought to compensate for the mass power of large concerns through such legislation as the state chain-store tax and Fair Trade Acts, the Miller-Tydings Act, and the Robinson-Patman Act.[21] Labor has attempted to strengthen its bargaining power by persuading government to set minimum labor standards and to guarantee and protect the right of collective bargaining. Farmers have organized to obtain large-scale government aid and to impose production, marketing, and price controls on the commodities which they produce. The result has undoubtedly been to increase the economic strength of hitherto weak interests; at the same time, additional rigidities are introduced into the economic system with possible lack of adaptive capacity in the face of changing economic conditions.

A sixth characteristic of the economy manifests itself in signs of increasing maturity. With the passing of the frontier and the exhaustion of free land, the period of land settlement has come to an end. Natural resources have largely been discovered and possessed. The rate of population growth is declining. The secular trend of industrial expansion appears to be no longer sharply upward. The community rate of savings continues high, but during the last decade the private sector of the economy has been unable to furnish adequate outlets for these savings in the form of new capital expansion.

[21] See Chapter 16.

Businessmen have avoided large long-term capital commitments; new investment has been closely geared to the current rate of consumer demand.

As a result of these and other developments, still another characteristic of the economy crystallized—the increasingly important role played by government. The obligation of government to provide a measure of economic security was recognized. The limited, laissez-faire view of the state gave way to a new conception of the positive service state, with government assuming major responsibility for maintaining the stability of the national economy and conserving resources, natural and human. The budget became a vehicle to redistribute income, to provide social services, and to expand public enterprise.

Some of the salient aspects of this vast increase in the economic powers of government will be analyzed in the pages which follow. It is important to remember that this increase may be only partly accounted for by the depression ushered in by the stock market crash of 1929. In a larger sense, it represents a response to the new world created by modern technology and industry. The insecurities which they have generated have led to a growing dependence on government to redress the balance and guarantee well-being. The old economy of small trade, free competition, and equality of bargaining power lent itself to adjustments on the economic plane. There was relatively little pressure for government to intervene. The new economy of large-scale enterprise, concentration of economic power, administered prices, and maladjustment of income invites political adjustments. The pressure for government to intervene comes from disadvantaged business groups, as well as farmers, laborers, investors, and consumers. The new activities of government reflect these demands; they crystallize the adjustments of a democratic community to the facts of the new economy.

Chapter Two. THE ORGANIZATION OF ECONOMIC INTERESTS

Three basic interests—business, labor, and agriculture—seek to determine the content of public economic policy in the United States. Each has its own primary objectives, its own special resources, its own organizational forms, and its own tactics and strategy. Each, in turn, is a mosaic of many particular interests, not necessarily harmonious and frequently expressing their aspirations through independent political activity. The pattern of evolving public policy reflects the interplay of these interests, their strength and their weakness, their skill in accommodation, and their ability to capitalize such resources as they have at their disposal. A realistic analysis of the activities of government in the economic system must take these interests into account, must consider their claims and their demands and the intensity of the pressure which they are able to bring to bear on the process of determining public policy.

1. The Politics of Business

The businessman's concern with government is no new phenomenon; wherever business and government have coexisted, the problem of adjusting their relationships has always arisen. The nature of this adjustment has varied; for long centuries the businessman was consigned to an inferior social and political status. In the determination of public policy, he was subordinate to the warrior, the priest, and the landholder.

The rise of business influence in the Western World is a relatively recent development. With the industrial revolution, the modern businessman began to come into his own and assert a new-found in-

dependence. He exerted his power to cast off the burdensome restrictions of law and custom which had been evolved to fit the needs of a feudal-aristocratic landholding society. In Europe he met varying degrees of opposition. In England and France he was comparatively successful in overcoming the resistance of agrarian, military, and church groups; in Germany, Italy, and Russia he encountered much more effective resistance from these quarters.

America presented a different picture. There was no feudal heritage to surmount, though the rise of the Southern slaveholding aristocracy soon presented an American analogue. The Southern slaveholding aristocrats might look upon the businessman with contempt, but, while they could resist, they were ineffective in checking his expanding power. Such influence as they could exert to impede the triumph of business enterprise was destroyed by the outcome of the Civil War.

The Civil War ushered in a new era of business ascendancy. As the wealth and power of the business community increased, government became increasingly sensitive to its demands and wishes. The influence of the successful businessman permeated the whole life of society. Social values were primarily business values, and politics was geared to the aspirations of the dominant business interests. To be sure, the businessman rarely played a public role in the political process. For the most part, he depended upon professional politicians to effect the necessary adjustments between business activities and public policies. His influence, however, did not suffer in potency because it was indirectly exercised.

The post-Civil War consolidation of business influence did not go unchallenged. Beginning at least as far back as the seventies, a ground swell of anti-big business and antimonopoly sentiment became apparent. But, despite periodic upsurges of popular dissatisfaction, business leadership pursued its course and was able to dissipate dissent with the visible evidence of rising national prosperity. The golden age of Coolidge registered this trend at its apogee.

There are many signs to indicate that this social milieu is now in process of reorientation. The depression years bred renewed disenchantment with business leadership. Labor, agrarian, and consumer groups became bolder in demanding, and more successful in invoking, the aid of government. As confidence in business leadership was undermined, these groups turned to government to attempt to provide that co-ordination of economic activity which the business

community in the depression years had failed to supply. An expanding network of regulatory statutes bore witness to the new trend. Businessmen found their calculations hedged about by the decisions of public officials, responding to group pressures which were not business pressures and seeking to protect interests which the businessman could not readily identify as his own. In the face of this apparent threat, business groups found themselves re-examining their political strength and resources, and readjusting their political methods in the hope of stabilizing their political relationships in a fashion more satisfactory to themselves. The American political front, which businessmen first conquered and then largely took for granted, has again become a vital arena and a scene of struggle in which many businessmen feel that the hegemony of business itself is at stake.

Consideration of the politics of business suggests a number of questions. Who are the businessmen? Is there a business community in any politically significant sense? To what extent do businessmen share common aims and objectives? To what extent are they divided by internal cleavages and conflicts? To what extent are businessmen organized for effective political action? What are the sources of their power and influence? How do they exercise influence?

Difficulties present themselves at the threshold. How shall the businessman be defined? The Bureau of Labor Statistics estimates that there are now about 4,300,000 proprietors and self-employed in nonagricultural pursuits.[1] Included within this group are representatives of every branch of business enterprise from the proprietor of the corner grocery store, who employs no labor and perhaps barely makes both ends meet, to owners and directors of large-scale banking, industrial, and financial concerns whose employees number tens of thousands and whose corporate assets run into the hundreds of millions and even billions. Is there any element of community among the various members of this group which justifies treating them as a coherent political unit?

Certainly the most cursory examination of the business structure discloses conflicts of interest and confusion of purposes among businessmen. Little business struggles against big business; high-cost producers seek political protection against low-cost producers; wholesalers and independent retailers organize politically against the chains in the struggle to control channels of distribution; importers

[1] T.N.E.C. *Hearings*, Part I, *Economic Prologue* (1939), p. 163.

oppose those interested in protecting the domestic market; regulated modes of transportation press for the extension of regulation to unregulated sectors of the industry; regional economic interests compete politically for freight rate as well as wage differentials; chaotically organized or depressed industries demand government assistance and regulation while other more prosperous industries bitterly oppose such pleas. The welter of intra- and interindustry competition, and the multitude of trade associations which have grown up to represent the particularistic interests of individual industries and trades, and local and regional combinations of them, may well serve as a warning against any oversimple characterization of the business community as an organic unit.

THE CONSOLIDATION OF BUSINESS INFLUENCE

Yet there is a sense in which it is permissible to speak of the consolidation of business influence. The reference here is not merely to the establishment and growth of comprehensive associations like the United States Chamber of Commerce and the National Association of Manufacturers, which seek to rally and unite business sentiment and speak for the business community as a whole. Of more fundamental import is the internal organization and discipline which has been impressed upon the business community by the growth of large-scale enterprise and the progress of the consolidation and concentration movement. The dominating position of clusters of large enterprises in important sectors of the national economy facilitates the development of homogeneity of outlook in the business community. Even more effective in fostering such homogeneity is the financial discipline imposed by interlocking financial relationships, banking connections, and similar channels of influence through which pressure can be, even if it is not always, exercised.

An anatomy of the business community today reveals an interesting pyramid of power. At the pinnacle are representatives of powerful banks, investment houses, insurance and holding companies, corporation executives, highly paid corporation lawyers, newspaper publishers, advertising and public relations experts. This group may be described as the "general staff" of "big business." Its members, no doubt, have their internecine battles and rivalries, but on the larger issues of public policy they form a fairly solid phalanx of opinion. Intimately knit together by social and financial ties, sitting on the same boards, exercising the same general responsibilities, they easily

develop a common point of view and a common outlook. Differences there may be on details of tactics and strategy, but on ultimate objectives there is a natural and understandable consensus.

Radiating from this central directing core extend various lines of influence. The powerful banks and investment houses have their spheres of influence among the smaller financial institutions; the latter, in turn, serve as a connecting link with small business. The corporate hierarchies, too, have their co-ordinating functions. Closely associated with the financial control groups and the top strata of corporation executives is a much wider circle of executives, junior executives, and well-paid technicians who, for the most part, reflect the views of the inner circle. At a still lower level, but yet well within the range of influence of the top business groups, are the lower managerial personnel, the foremen, overseers, and inspectors, and many of the so-called "white-collar" workers, who, though they receive their income largely as salaries, frequently adopt the outlook of employers rather than employees. Nor does this exhaust the range of business influence. The loyalties of the so-called investor class—those who live largely on investment income—can ordinarily be depended upon to rally around business leadership. Under favorable economic conditions, business influence may even penetrate deeply into the ranks of industrial workers, though efforts to cement the allegiance of such groups to business leadership have met increasing resistance.

The extent of business influence is obviously not a fixed quantum. It is capable of expansion and contraction depending on the nature of business leadership and economic developments. Odegard and Helms have recently suggested that "a conservative estimate of the numerical strength of business groups in America would be between 6,000,000 and 8,000,000 persons, representing easily twice that many votes." [2] Whether or not this estimate be accepted as accurate, it is at least clear that the so-called business community is a potent political group, subject to a considerable degree of centralized direction at the top, possessing a well-organized hierarchical apparatus to bind together and discipline its dependents, and equipped with resources capable of being used to appeal for and enlist widespread support.

What are these resources? Command of economic wealth is, of course, the keystone of business strength. The prestige of the business community may rise in good times and decline when times are bad,

[2] P. H. Odegard and E. A. Helms, *American Politics* (1938), p. 247.

but as long as it retains major control of the economic assets of the nation it possesses a potent weapon to make its influence felt. The power to grant or withhold employment and the ability to make important price, production, and investment decisions are powerful instruments which may be utilized for business political ends. Economic power, moreover, may be transmuted into political power in an even more immediate and direct sense. The cruder varieties of direct purchase of votes, politicians, and officials may no longer be commonly in vogue, but more refined and equally effective techniques are available. Campaign contributions to either or both major political parties, the promise of business preferment dangled before the eyes of ambitious public figures, the subsidy of pressure groups, a heavy ownership stake in the press, radio, motion-picture, and other opinion industries which mold public sentiment, an intensive cultivation of public relations, the employment of high-priced counsel to erect legal barricades against the expansion of governmental regulation—these and their variants are the levers through which business influence on the political process can be exerted.

THE METHODS OF BUSINESS POLITICS

Practitioners of the politics of business have various methods at their disposal. One may be called the method of persuasion, a second the method of attrition, and a third the method of concession or compromise.[3] Each of these methods may be practiced by the same business groups at different times; sometimes, elements of each may be used at the same time.

The method of persuasion as used here embraces everything from direct economic pressure at one end of the scale to any form of presentation of business aims and objectives to the general public at the other end. Economic pressure may take the form of threats of economic injury for undesired conduct, or it may take the form of bribes or other kinds of rewards to induce desired conduct. The presentation of business aims and objectives may involve utilizing

[3] Some would add a fourth method, the method of coercion. The use of "big-stick" methods has been particularly common in dealing with labor difficulties, although it has by no means been confined to that field. Business violence in the labor field has recently come in for elaborate scrutiny by the La Follette Committee on the Violation of Free Speech and Rights of Labor, and the findings of that investigation may be consulted to illustrate the strategy of coercion at work. See *Report* of the Committee on Education and Labor, Violation of Free Speech and Rights of Labor (76th Cong., 1st Sess., 1939). See especially *Report No. 6,* Part II.

every medium of reaching the public or governmental agencies—radio, newspapers, motion-pictures, outdoor billboards, advertisements, booklets, speakers, and the like—and it may include every variety of effort to manipulate, mold, or affect public opinion.

It is the stress on the molding of public opinion and on the direct appeal to the electorate which distinguishes the modern application of this strategy. Some old-style, rough-and-tumble businessmen were more defiant of public opinion. W. K. Vanderbilt's "The public be damned," George F. Baker's "It's none of the public's business what I do," H. O. Havemeyer's "Business is not a philanthropy" were forthright, if incautious, expressions of an indifference to public sentiment characterizing some members of an earlier generation of business leadership. Voters, politicians, and legislators were regarded as commodities to be bought. Nice scruples could not be tolerated in the ruthless pursuit of business objectives.

The revulsion of popular feeling which such tactics provoked forced a readjustment of business tactics. Businessmen began to take thought to placating public opinion. A significant reorientation in the character of business politics became evident. Direct economic pressure on legislators and officials was not abandoned, particularly where it could be effectively employed without inviting a political boomerang. But the new stress was on the appeal to public sentiment, on the application of high-pressure methods of manipulating public opinion. Hanna's management of the McKinley campaign marked the first nationally significant use of the new techniques. To be sure, direct economic pressures were not dispensed with in the course of the campaign. But perhaps, in the long run, more significant were the importation of advertising methods into politics, the use of clever slogans and posters, the distribution of "boiler plate" to newspapers, and the marshaling of public opinion on a national scale. Hanna's methods quickly found imitators among business groups with political problems. The railroad struggle against the Hepburn Act of 1906 reproduced the same pattern of techniques. The activities of the utility industry during the twenties and the battle against the Utility Holding Company Act in 1935 represent instances of more modern applications, though examples could be multiplied. What is of primary significance is the new disposition of business, particularly big business, to seek safety from political attack in strenuous efforts to mold the basic political attitudes of the electorate. Public relations, skillfully cultivated and vigorously di-

rected to implant probusiness symbolism in the minds and hearts of the voters, has become the wizard's wand which is expected to solve many political problems.

A second method sometimes employed by business groups is the method of attrition. This involves conduct on the part of business groups designed to delay, discredit, or prevent the execution of a policy which has received the approval of the electorate but which is deemed objectionable by businessmen. The time-honored reliance on litigation to obstruct unpalatable legislation may be cited as one example of the application of this method. It is difficult to think of any important expansion of state or national regulatory authority in the field of business activity which has been unattended by an outburst of lawsuits designed to create impediments in the way of such expansion. From the first legal assault on the Interstate Commerce Act of 1887, which, in effect, rendered the Interstate Commerce Commission impotent for nearly twenty years after its establishment, until the more recent legal barrage against various phases of the New Deal, this technique has been persistently and, to a considerable degree, successfully employed. Needless to say, the right to question the constitutionality of a legislative act or the legality of administrative action is not in question; it is the irresponsible use of this right as a method of waging guerrilla warfare against undesired regulatory activities which is here identified with the method of attrition.

Rear-guard action of this type has not been confined to litigation. Unwelcome regulation may be frustrated by withholding business co-operation where business co-operation is essential to the effectiveness of such regulation. Where legislative objectives are unacceptable to business, business pressure may still be exerted to guide the administrative application of these objectives into channels which will be more acceptable to business. To preserve the appearance of accepting regulation, while rendering the substance harmless, is a technique which business has not overlooked, to which the history of state regulation of utilities during the twenties bears witness.

A third method which has also been used involves concession or compromise. Far-sighted and realistic business leadership has recognized the advantages of placating opposition, and, on occasion, has followed the Bismarckian and "Tory Socialist" tactic of attempting to defeat reform by annexing it. The method of concession or compromise has always bulked large in business politics when the support of other groups has become vitally essential to the realization of

business objectives in the field of public policy. But the price which business has been willing to pay for such support has ordinarily depended upon the strength of the groups which it has been found necessary to placate. Before the advent of organized labor as an important political force, the most important groups which required placating were the agrarian interests. But farmers until the turn of the century encountered difficulty in organizing their strength; the concessions which businessmen were required to make to ensure agrarian support were of a minimal variety. As both agrarian and labor groups have become more effectively organized, business politicians have found it essential to make greater concessions.

In the preceding discussion the politics of business has been analyzed in terms of methods employed. The choice of a method may be conditioned by various circumstances—the character of the particular business or businesses involved, the resources available to businessmen, the strength of opposition, and the general economic or political setting. The choice of a method involves no final commitment to adhere to it alone; unsuccessful methods may be freely discarded and more promising lines of action freely adopted. Method is subordinate to end; each course of action must ultimately meet the test of proved or probable effectiveness in realizing the goal which businessmen have set.

The goal of business politics can be minimally and generally stated in survival terms. But the conditions of survival are appraised differently by different sections of the business community. To the small businessman who feels himself threatened by big business, the conditions of survival may present themselves in vigorous enforcement of the antitrust laws, in legislation penalizing chain stores and other forms of bigness, in government provision for his credit needs, etc. Big business, on the other hand, is likely to resist every governmental effort to penalize bigness. In similar fashion, the peculiarities and special needs of particular businesses dictate very different attitudes toward government. With some, the plea is for direct aid, for tariff protection and subsidies. In the case of the air transport industry, which is still in the developmental stage, or the railroad, merchant marine, coal, and other industries which find themselves in financial distress, the cry is for assistance. With other more prosperous, established, and expanding industries, the plea is for nonregulation or a minimum of regulation. With still others, such as the public utilities which acknowledge their public service obligations

yet seek stability in their relationships with government, the demand is for "reasonable" regulation. Differences among businessmen in their political objectives necessarily dictate differences in methods of appeal. Each group adopts techniques to fit its own special needs. The structure of modern business is too complex to expect unanimity of program or strategy over the whole range of its operations.

Nevertheless, efforts to achieve such unanimity have been made in the past and will probably be even more vigorously prosecuted in the future. The concentration movement, as has already been indicated, provides a powerful internal discipline. The growth in the strength, organization, and bargaining power of nonbusiness and antibusiness groups in recent years has served as a challenge to businessmen to unite and rally their efforts. The result has been particularly evident in the growing self-consciousness of big business since 1933. Faced with what it regards as an accelerating tide of hostile regulation, big business has responded by practicing the method of attrition and resistance where possible and by indulging in concession or compromise where no other expedient has been available. But, far more significantly, it has recognized that its "old easy-going reliance on the professionals of politics to temper the tides of political unrest has become increasingly untrustworthy." [4] The result has been a vastly increased emphasis on public relations activity in an endeavor to mold the basic political attitudes of the electorate.

What success these efforts will enjoy is as yet by no means clear. Even the most distinguished of practitioners of the new art of public relations entertain occasional doubts. One of them has recently referred in scathing terms to the erroneous conception "that a broken-down newspaperman luxuriating on a salary of $5,000 a year can conceal all the evils in a corporate record and coax hosannas from the public with the output of an agile typewriter." [5] Even if business leaders succeed in checking the tide of reform by inducing a more favorable attitude toward business in the public mind, the symbolism which they will have implanted will probably not prove ultimately viable unless it is accompanied by returning prosperity and a demonstration that business leadership can supply the tangible benefits which its spokesmen promise.

[4] Norton E. Long, "Public Relations of the Bell System," *Public Opinion Quarterly*, Vol. 1, No. 4 (October, 1937), pp. 5–6.

[5] Glenn Griswold, "Public Relations—Some Misconceptions," *Public Opinion Quarterly*, Vol. 1, No. 3 (July, 1937), p. 126.

2. The Politics of Labor

If organization be the *sine qua non* of power, labor has still to realize its potentialities. In spite of the tremendous stimulus to labor organization provided by the Wagner Act and other New Deal measures, in 1940 the number of organized workers, including those affiliated with the A.F. of L., the C.I.O., and the Railroad Brotherhoods, probably did not exceed eight million. This was less than 25 per cent of the approximately thirty-five million workers eligible for membership in unions. More than half of this eight million total of organized workers represented gains of recent origin.

Organization has proved most feasible among skilled urban workers, especially in mines, factories, building, and transportation, and has spread only slowly to the unskilled and to clerical and low-income professional groups. Even among the organized, internal cleavages have been widespread and recurrent. Sectional antipathies, opposition of skilled to unskilled workers, of rural to urban workers, craft rivalries, conflicts between craft and industrial lines of organization, nationalist cleavages among immigrants, opposition between "native" and "alien," violence and "racketeering," all have played their part in labor history. Employers and employees in a particular industry frequently act together to urge upon government their common interest in special protection against competitors. Thus, the "labor interest" is far from unified; the labor movement is far from unanimous in agreement on its objectives or its methods.

THE DEVELOPMENT OF LABOR ORGANIZATION

Trade-union organization first appeared in this country toward the end of the eighteenth century among skilled craftsmen in the leading commercial centers, Philadelphia and New York. Each group was limited to a single craft in a single locality. They sought to defend their wage levels and in some cases to provide insurance on a mutual benefit basis. Common-law antipathy, inherent weakness, and obsolescence of some of their crafts as the industrial revolution introduced new machine techniques made these unions very short lived. During the eighteen-twenties and thirties, the pressure of monetary inflation on workers' standards of living and the increasing growth of factory and machine production led to the formation of local labor unions, which were federated together in groups in various cities. These unions participated in the political Workingmen's Party, sponsored

early protective legislation, and promoted direct bargaining for improved conditions, but were reduced almost to the vanishing point by the severe depression of 1837. Only in mid-century did modern trade-unionism begin to emerge. Accelerated by the Civil War, it arose from the altered pattern of industrial organization, which depended, in turn, upon the revolution in transportation and in corporate organization.

Two parallel trends, varying in intensity and occasionally conflicting with one another, have characterized the labor movement since the Civil War. The first has been the organization of national unions based on craft lines, composed of skilled and better paid workers. These groups have retained their greatest vigor in fields least penetrated by mass production methods, like the building trades (carpenters, electricians, hod carriers, painters, bricklayers, plasterers, plumbers, structural ironworkers, etc.), printing, metalworking, and railroad transportation. While representing only a small fraction of American workers, these relatively conservative labor unions, which for the most part were enrolled in or allied with the American Federation of Labor, held unquestioned sway over the labor movement between 1900 and the advent of the New Deal. The second trend, more amorphous and until recently comparatively unsuccessful, has sought to organize the unskilled and semiskilled workers in factories, mines, and fields. It was manifested sometimes in industrial unionism, sometimes in the demand for "one big union," sometimes in socialist political action, sometimes in syndicalist, antipolitical "direct action."

National craft unions, many of which have maintained their existence unbroken to the present day, first took shape in modern form in the eighteen-fifties and sixties. They concentrated on "business unionism"—the improvement of their own wages, hours, and working conditions—with only incidental interest in wider reform or in general politics. An attempt to weld their membership into a National Labor Union, which lasted from 1866 to 1872, collapsed when the new body diverted its attention to land and monetary reform. These issues were crucial to farmers, but of little interest to labor. The Industrial Congress, formed in 1873, was another abortive attempt at intercraft organization, which broke on the rocks of the severe depression beginning in that year. Effective and permanent association of craft unions under common leadership proved im-

possible until the establishment of the American Federation of Labor in 1886.

During the depression of 1873, business unionism was of no avail. Some workers turned to secret, violent methods, characterized by the terrorism of the "Molly Maguires" in the Pennsylvania coal fields and the Pittsburgh railroad riots of 1877. At the same time, a comprehensive organization seeking to unite all labor in "one big union" arose as the "Noble Order of the Knights of Labor." Originating as a secret society in Philadelphia in 1869, it dropped the mantle of secrecy in 1881 and in a few years became the largest and most significant organization American labor had produced. It suffered, however, from lack of concretely defined objectives, conflicts between humanitarian reformers and advocates of revolutionary political and economic action, disputes over politics, and friction with craft unions. Including seven hundred thousand members at its height in 1886, it became the victim of public hysteria after the Haymarket explosion in Chicago, and rapidly lost membership to the directly antagonistic, conservative American Federation of Labor.

THE AMERICAN FEDERATION OF LABOR

From 1890 to 1936, the history of the American labor movement is largely the history of the American Federation of Labor.[6] The sole opposition of consequence to its supremacy during this period came from the Industrial Workers of the World. The I.W.W. was formed in 1905 around the core of the radical Western Federation of Miners, other industrial unionists, and small socialist groups in the East. It began as a movement for organization of unskilled miners, factory workers, and migratory farm laborers and lumbermen behind a program of militant industrial unionism and political socialism. It attacked the A.F. of L. for its acceptance of the capitalist system and its failure to organize the unskilled, and was assailed, in turn, as an irresponsible mob of "un-American" revolutionaries. Shortly before the World War of 1914–18, its leadership fell to a syndicalist faction, aiming at seizure of the economic order by "direct action." In the war and immediate postwar years, the organization was widely attacked by federal and state officials under the Espionage Act and the crop of "Criminal Syndicalism" laws which swept the country in

[6] The Railroad Brotherhoods, though organized independently, worked closely with the Federation.

an intense wave of antiradical emotion. The I.W.W. subsequently declined to a position of slight importance. Yet its rise and prewar strength were indicative of serious defects in the A.F. of L. as a representative labor organization.

The structure and policies of the Federation were stamped upon it by the personality of Samuel Gompers, who held the presidency continuously from 1886 until his death in 1924, except for the year 1895. Formerly a socialist, he had become convinced that under American conditions a stable and effective labor organization must confine itself to business unionism, the "here and now," the search for "a fair day's wage for a fair day's work." While industrial unionism was not forbidden within the ranks of the A.F. of L., and was indeed represented by two of its most powerful constituents, the United Mine Workers and the United Brewery Workmen, craft unions were preferred and craft autonomy jealously guarded. The A.F. of L. vigorously condemned as "dual unionism" any effort to organize the unskilled outside the Federation. It set its face against third-party politics, whether independent or in co-operation with farmers. It distrusted reliance upon government but, as far as government aid was deemed necessary, it adopted the nonpartisan tactics in voting, of "rewarding its friends and punishing its enemies" regardless of party affiliation. In the years since the war, its leaders have been as vociferously anticommunist as those of any group in the country.

The tactics of the A.F. of L. maintained a stable, nation-wide labor organization for the first time in American history. On the other hand, there were marked shortcomings in its effectiveness as an organizer of labor as a whole. The proportion of workers organized into unions remained far lower than in other industrialized countries. The Federation's growth was slow, reaching the million mark only by 1902. In its earliest years, member unions lost the spectacular Homestead strike in 1892 and the strike against the Pullman Company in 1894. Since state militia in the former, and federal injunctions and troops in the latter, had played a decisive role, the demand for independent political action was given new impetus, and quarrels on that issue badly divided the young organization. Its first important successes took place during the prosperous years from 1898 to 1902, a period which saw a great wave of corporate consolidations.

These years also witnessed the beginnings of employer organization for militant antiunionism. The National Association of Manu-

facturers after 1903, the American Anti-Boycott Association (later the League for Industrial Rights), and certain trade associations made the "open shop," which in practice meant the nonunion shop, the core of their programs. They sought not merely to win over employers, but also to gain sympathy from the general public. The stream of labor injunctions first appeared in significant proportions in these years. Thus the Federation had to make its way against employer antipathy, judicial hostility, internal dissension, and leftward challenge from the I.W.W.

At the beginning of the first World War, the A.F. of L. was firmly established. It had over two million members; it had won from the Taft administration a special Department of Labor and from the Wilson administration the labor sections of the Clayton Act.[7] It had a strong lobby at Washington, paralleled at many state capitals by the lobbies of State Federations of Labor. The movement had evoked a good deal of public sympathy during the "muckraking" era of the first decade of the century, and the principle of organization was approved by a special government Commission on Industrial Relations in 1915. But it suffered from a basic weakness. Structural developments, particularly in large-scale industrial organization, were becoming less and less favorable to the craft unionism on which the A.F. of L. was based. It failed to include the mass production workers whom the new technology was making increasingly numerous and important. It was precisely in those industries that employer organization for collective resistance was strongest; yet in the face of this united opposition the craft form of organization divided workers into small separate groups, which often bickered over fine jurisdictional issues. The Federation made halfhearted efforts at organizing the unskilled and semiskilled into directly affiliated "federal labor locals," but refused to accept industrial unionism as an alternative to the craft lines wherever they might conflict. Its encouragement of craft amalgamations was not sufficiently forceful to reduce jurisdictional quarrels to any appreciable extent.

The consequences of this structural weakness were temporarily postponed by the war. The war boom, coupled with cessation of immigration, greatly improved labor's bargaining position. The friendly Wilson administration passed the La Follette Seamen's Act for the improvement of the conditions of maritime workers, two

[7] For provisions see Chapter 6.

federal child labor acts, and the Adamson Act[8] giving railwaymen the basic eight-hour day. Upon our entrance into the war, Federation officials were recognized in a variety of ways as labor's spokesmen. The War Labor Board, established in 1918, gave government sanction for the first time to the right of labor organization and collective bargaining, and forbade discrimination in employment on account of union membership or activity, although it did not promote the closed shop as such. When the regulatory boards were dismantled in 1919, and a short-lived inflationary boom set in, a wave of strikes swept the country, among the most important of which were strikes by steelworkers and coal miners. Both of these major strikes were beaten, the latter with government aid. The tide began to turn against the A.F. of L., which reached its peak in 1920 with over four million members. The enthusiastic ideas of "industrial democracy," of widespread social reconstruction, and of the socialization of railroads and other public utilities were swept away in the rising tide of reaction. The Federation leadership itself became frightened of labor radicalism and the third-party movement; it set its face against both.

For the first time in a period of industrial prosperity, labor organization failed to advance during the nineteen-twenties. From 1923 to 1931, A.F. of L. membership remained almost constant at somewhat under three millions. Employer organizations revived militant antiunionism under the name of the "American Plan" open shop. Many employers adopted plans of "scientific" personnel management, frequently including employee representation plans or company unions for workers in each separate company. This was considered a substitute for independent unionism, which was frequently directly forbidden to employees through the "yellow-dog" contract. Labor injunctions were handed down by the courts in unprecedented numbers, together with a series of Supreme Court rulings invalidating labor legislation.[9] Company-operated welfare plans and stock sharing with employees often removed the incentive to independent unionism. Meanwhile, the technological developments disfavoring craft unionism proceeded apace. The failure of the Federation to

[8] Although the leading organizations pressing for this measure were the four Railway Brotherhoods, the only important craft unions not affiliated with the A.F. of L., the Federation supported them in this move. For further discussion of the Adamson Act and related measures see Chapter 6, below.

[9] See Chapter 6.

attempt organization of the automobile industry, owing largely to intercraft jealousies and their reluctance to approve an industrial union even as a temporary device, brought out the weaknesses of the A.F. of L. in sharp relief. Efforts made within the A.F. of L. organization toward more effective methods were repeatedly thwarted by dissension over alleged communist influence and by squabbles among left-wing splinter parties. A single experiment in third-party politics, support for Senator Robert M. La Follette's Independent presidential candidacy in 1924, was looked upon as a failure. The general decline in labor morale was accentuated by the depression of 1929. By 1933, Federation membership was down to little over two million.

As depression deepened, unemployment widened, and wages diminished, labor leaders were forced toward increasing demands for government assistance. In 1932, the A.F. of L. reversed its long-established stand against unemployment insurance. It also advocated "spreading the work" through universal adoption of the thirty-hour week and a modicum of "economic planning."

THE NEW DEAL AND THE EMERGENCE OF THE C.I.O.

The New Deal gave a strong impetus to labor organization. Between the summer of 1933 and the winter of 1934–35, membership in A.F. of L. unions increased by more than a million workers. During the next year, however, the pace of growth slackened as employer resistance mounted. Organization in the mass production industries was seriously hampered by the reluctance of powerful A.F. of L. craft unions to surrender jurisdictional claims and permit organization on an industrial basis. Advocates of industrial unionism within the A.F. of L. made a determined effort to overcome this reluctance, but met defeat at the 1935 convention. In November, 1935, they organized a new Committee for Industrial Organization with John L. Lewis, President of the United Mine Workers, as chairman. Under the auspices of this group a vigorous organizing drive was launched in the mass production industries and striking gains were made in steel, automobile, rubber, radio, electric manufacturing, and other hitherto unorganized fields. By September, 1937, the C.I.O. claimed a membership of over three and one half million. Meanwhile, however, the controversy between the A.F. of L. and the C.I.O. unions was rapidly coming to a head. In 1936 the C.I.O. unions were suspended from the A.F. of L., and in 1938 all of them, with the exception of the International Ladies' Garment Workers' Union, were

formally expelled from the organization. Later that year, the C.I.O. changed its name to the Congress of Industrial Organizations and established itself on an independent basis.

The full political effects of this split were not immediately apparent. In the 1936 campaign, both wings of the labor movement were substantially united in their support of the New Deal. Yet the contrast in tactics employed was illuminating. The A.F. of L.'s support was given indirectly, in accordance with the traditional policy of standing by friends and opposing enemies. No effort was made to use the central machinery of the A.F. of L. to raise a campaign fund for political purposes. The C.I.O. leadership, on the other hand, supported the New Deal with large financial contributions and cooperated with favorably disposed A.F. of L. unions in establishing Labor's Non-Partisan League to recruit votes. The vigor of the campaign directed by the League struck a new note in labor politics. The New York branch of the League, under the name of the American Labor Party, was particularly active and played an important role in electing Governor Lehman in 1936 and Mayor La Guardia in 1937. As a result of the deepening cleavage in the labor movement and the more conservative drift of the electorate, C.I.O.-supported candidates in Pennsylvania, Michigan, and other industrial states met with severe reverses in 1938. The 1940 election found the C.I.O. divided, with most of its rank and file and many of its influential leaders supporting Franklin D. Roosevelt for a third term, while John L. Lewis and a group of his devoted admirers declared for the Republican candidate. As a result of the outcome of the election, Lewis resigned as head of the C.I.O. and was replaced by Philip Murray, who had worked for the re-election of the President.

The new emphasis of the C.I.O. on politics is the direct corollary of an altered attitude toward the role of government. The A.F. of L. in the past depended primarily on its skill and job monopoly rather than on government protection to safeguard its status. The C.I.O., with its mass base in easily replaceable unskilled and semiskilled labor, is more vitally dependent on sympathetic government action to protect its bargaining position as well as its living standards. Thus, John L. Lewis, in an article entitled "What Labor is Thinking," expressed this new point of view:

> Time was, before the depression, when the representative labor leader would have said: "Guarantee labor the right to organize and we shall do the rest." Now he knows that modern, mass-production industry—not only

natural resources industries, but the manufacturing and mechanical industries as well—are un-co-ordinated, uncorrelated, and overcapacitated. With the guarantee of "the right to organize" such industries may be unionized, but, on the other hand, better living standards, shorter working hours, and improved employment conditions for their members cannot be hoped for unless legislative or other provision be made for economic planning and for price, production, and profit controls. Because of these fundamental conditions, it is obvious to industrial workers that the labor movement must organize and exert itself not only in the economic field, but also in the political arena.[10]

As this extract makes clear, the C.I.O. looks to government to supply conscious direction in guiding the economy toward full production. It endorses not merely special regulation for industries in which it has an immediate interest, like coal and textiles, but a program of positive regulation for the entire economic order, with labor participation in administrative agencies. If this attitude becomes widely accepted in labor circles, it foreshadows an intensification of political activity by the labor movement.

Meanwhile, the persisting cleavage between the A.F. of L. and the C.I.O. continues to produce internecine warfare and to dissipate labor's political influence. Until the breach between the two wings of the labor movement is healed, the full political strength of the labor movement will still remain to be realized.

3. The Politics of Agriculture

Farmers, like businessmen and workers, seek to promote their interests through organization. The business community is bound together by a highly centralized system of banking, financial, and corporate interrelationships. The factory provides a natural nucleus around which labor can coalesce. But the task of bringing farmers together presents special difficulties—obstacles of isolation, distance, and inbred individualism which are not easily overcome. Diversities of interests among farmers themselves have accentuated these difficulties. Dairy farmers, grain growers, sheep and cattle raisers, cotton growers, and fruit farmers each have more or less distinct interests which induce commodity consciousness rather than a broader agrarian consciousness. Growers of export crops feel differently about tariffs than do producers of wool or sugar who enjoy protection.

[10] *Public Opinion Quarterly*, Vol. 1, No. 4 (October, 1937), p. 27.

Farm owners do not necessarily share the outlook of farm tenants, farm laborers, or migratory workers.

Despite these differences and difficulties, and despite the dwindling importance of the rural element in the total population, the political strength of agriculture in recent years has been formidable. The explanation is many sided. The plight of agriculture has spurred co-operation and submergence of differences among farmers themselves. Government agencies, particularly under the New Deal, have provided a strong impetus to organization. With the emergence of sharp business-labor cleavages in the industrial sector of the economy, the political significance of the farmers as a balance-of-power group has increased. This factor becomes all the more important in national politics because the composition of the Senate ensures a majority of Senators from rural states and the apportionment of seats in the House of Representatives favors the rural population. This same tendency toward rural overrepresentation is also present in most state legislatures.

Until the post-Civil War era of rapid industrial expansion, the rural population in the United States was in a clear majority. Agrarian interests dominated the calculations of successful party politicians. The parties of Jefferson and Jackson made their primary appeal to farmers and planters. "The agricultural interest of our country," said Jackson in his first annual message to Congress, December 8, 1829, "is so essentially connected with every other and so superior to them all that it is scarcely necessary to invite to it your particular attention. It is principally as manufactures and commerce tend to increase the value of agricultural productions and to extend their application to the wants and comforts of society that they deserve the fostering care of Government." The possibility that the growth of manufacturing and commerce would shift the balance of political forces and generate effective opposition to the dominant agrarianism was not yet clearly envisaged.

The cleavages introduced by the slavery issue and the outcome of the Civil War helped to accelerate changes which were already foreshadowed by the gathering force of the New Industrialism. The Republican Party, profiting from the temporary disfranchisement of the South, sought to consolidate the industrial strength of the East and the agrarian elements of the West in a new political combination. The bid for agrarian support was largely based upon the promise of free land contained in the Homestead Act of 1862 and a policy of

liberal internal improvements. The appeal to industry was mainly centered on a rising protective tariff, though "sound" money policies, banking legislation, railroad land grants, and new opportunities for railroad construction also played major roles.

AGRICULTURAL DISCONTENT AND THIRD-PARTY MOVEMENTS

As the years passed it became evident that the Republican Party offered more to industrialists than it did to farmers. Agrarian dissatisfaction began to express itself with the decline of agricultural prices in the seventies. Credit stringency, high railroad rates, and alleged gouging by middlemen contributed to agrarian discontent.

The first major revolt was the Granger movement. The National Grange of the Patrons of Husbandry started in 1867 as a secret fraternal order of farmers, stressing social and educational objectives. During the hard times that accompanied the depression of 1873, it took a political turn and called for regulation of warehouses and railroads, control of monopolies, reduction of the farmers' tax burden, creation of a department of agriculture, and broader government services for agriculture. In a very short time, it built up a membership of approximately a million, captured control of a number of Midwestern state governments and enacted legislation providing for regulation of railroads and warehouses. But the Granger triumph was short lived. With the temporary improvement of farm prices and the failure of a number of ambitious co-operative enterprises launched by the Granger movement, its membership and political strength declined, and much of the legislation which it had sponsored was repealed. During the next decade the more radical residue of the Granger movement found an outlet in the Greenback Party (1876–84), which called for currency inflation as a cure for agricultural ills.

With the revival of agricultural distress in the late eighteen-eighties, a new impetus was given to independent political organization. Two separate Farmers' Alliances appeared, one in the North and the other in the South, and in the election of 1890 three Senators and fifty Representatives were returned who were pledged to support the antimonopoly, the currency reform, and the railroad regulation program of the Alliances. Successes scored in the election of 1890 stimulated agitation for organization of a third party on national lines, and in 1892 the Populist Party was born. But again, as with the earlier Granger movement, decay soon set in. Though the Populist Party polled twenty-two electoral votes and over a million popular

votes in the election of 1892, it was absorbed into the Bryan-led Democracy and went down to defeat in the Free Silver battle of 1896. With rising prices and returning agricultural prosperity after the turn of the century, the Populists dwindled into insignificance.

Since the Populist experiment, no effort has been made to build a national third party on a primarily agricultural base. The Progressive candidacies of Theodore Roosevelt in 1912 and La Follette in 1924 were designed to appeal to farmers, but only as part of a larger combination of middle-class labor and farmer interests. Sporadic, and at least temporarily successful, efforts have been made to build independent farmers' political movements in some of the rural states. Perhaps the most notable of these experiments was the Nonpartisan League, which originated in North Dakota in 1915 and spread to adjoining states.

Unlike earlier farmers' movements, the Nonpartisan League was not a product of depression; its growth was primarily a tribute to the organizing genius of its founder, A. C. Townley, and to his ability to capitalize resentment against alleged extortion by middlemen in the marketing process. The League developed its most effective strength in North Dakota, where it entered the Republican primary, captured control of the party and of the state government, and enacted a program providing, among other things, for state-owned grain warehouses, elevators, and flour mills, a state-owned bank, hail insurance, regulation of railroad freight rates, and a graduated income tax. With this program achieved, internal dissension developed; a process of disintegration set in and the League declined in influence. Meanwhile, efforts of the Nonpartisan League to invade Republican and Democratic primaries in other states were less successful. In Minnesota the League abandoned the strategy of attempting to capture the Republican Party and joined with city workers in establishing an independent Farmer-Labor Party, which came to play an important role in the politics of the state.

THE FARM BLOC

The collapse of the agricultural war boom in 1920, and the prolonged farm depression which ensued, inaugurated a new phase in agrarian politics. This time no effort was made to build a new party; instead, farm strategy was concentrated on electing to Congress sympathetic members of both major parties, welding them into a disciplined Farm Bloc, and utilizing the balance-of-power position

of the Bloc to advance agrarian interests. The establishment of the American Farm Bureau Federation in 1919 provided much of the driving force behind the organization of this Bloc. In May, 1921, twelve Senators, headed by Senator Kenyon of Iowa, met in the office of the American Farm Bureau Federation and agreed to work together to relieve agricultural distress. They were subsequently joined by others, and a somewhat less effective agrarian steering committee was established in the House.

The Farm Bloc showed surprising vigor and political efficiency. The passage of the Packers and Stockyards Act of 1921, the Grain Futures Act of 1922, the Agricultural Credits Act of 1923, and the Co-operative Marketing Act of 1926 may all be credited to the work of the Bloc. But more ambitious measures of farm relief encountered difficulty. Though the McNary-Haugen Bill twice passed Congress, it was also twice vetoed by President Coolidge, and the Farm Bloc was unable to muster sufficient strength to override the Presidential vetoes. After 1924 the Farm Bloc declined in influence; sectional rivalries between South and West hampered effective common action.

The intensification of farm depression after 1929 forced farm groups toward a united front. In 1932 the American Farm Bureau took the leadership in calling a conference of leading farm organizations to agree on a legislative program. President Roosevelt promised in his acceptance speech "to be guided by whatever the responsible farm groups themselves agree on," and farmers in great numbers flocked to his support.

With the entry of the New Deal, farm organizations came into their own. The content of the Agricultural Adjustment Act of 1933 was worked out in intimate consultation with farm leaders, and subsequent agricultural legislation registered the influence of farm groups at virtually every stage of formulation and execution.

FARM ORGANIZATIONS TODAY

In 1940 three major organizations undertook to represent the general interests of American farmers: the National Grange, the Farmers' Educational and Co-operative Union of America, and the American Farm Bureau Federation. The Grange, which was the oldest of the trio, traced its origins back to the Granger movement. It claimed eight hundred thousand members, largely concentrated in the Northeast—New England, New York, Pennsylvania, New Jersey, Michi-

gan, and Ohio—and on the Pacific coast. Its membership included many nonfarmers, residents of small towns who were attracted by its social activities. Its farmer membership consisted mostly of fruit and vegetable growers, dairy and poultry men. On the whole, they represented the more prosperous strata of farmers and were inclined to be "conservative" in their political behavior. While supporting the general objective of "equality" for agriculture, they were critical of production control and opposed to the trade agreement program.

The Farmers' Union, on the other hand, was the "radical" of the trio. Its claimed membership of five hundred thousand was heavily concentrated in the Dakotas, Nebraska, Kansas, Oklahoma, Colorado, and Montana areas, which had been hard hit by drought. As producers of wheat, corn and hogs, and cotton, its members had suffered particularly severely in the prolonged agricultural depression. The result was a mood of desperation. The New Deal agricultural program, while accepted as far as it went, was deemed inadequate. Leaders of the Farmers' Union demanded legislation which would guarantee farmers "cost of production." They were prepared to go much further than other farm groups in co-operating with labor to achieve a "co-operative commonwealth."

The American Farm Bureau Federation, with one million, five hundred thousand members, was the largest of the three organizations. Its constituent units, the county farm bureaus, were called into being originally to provide co-operating local groups to support the work of the county agents. In 1919 these local groups were united into the present national organization. While the Farm Bureau was particularly strong in the Midwest and the South, it also had a large membership in both New York and California. Since both the membership and the commodities represented were diverse, the Farm Bureau was able to take "middle ground"; its objective was "to give farmers a national voice that all groups can unite in." The Farm Bureau took a leading role in the enactment of the Agricultural Adjustment Act and it continued to provide the most important reservoir of support for New Deal agrarian controls. It demanded that Congress increase agricultural payments to give farmers full parity with industry but, unlike the Farmers' Union, it seemed to be prepared to settle for less.

In addition to these general groups, there were a host of organizations which represented particular commodities or forms of marketing organization. Among these were the National Co-operative Milk

Producers' Association, the National Livestock Producers' Association, the National Co-operative Council, and many others. Each commodity had its organizational voice, and the orchestration of agricultural politics gave most of them full expression.

The significance which public policy and administration have come to assume for farmers in recent years has necessarily had the effect of intensifying the pressure for organization. When legislation becomes the *sine qua non* of economic survival and welfare, obstacles to organization are overcome and conflicting interests are reconciled. At the same time, the growth of organization has itself been fostered by the more favorable political milieu in which farm groups have operated. The New Deal has provided a stimulus, and Republicans have been willing to offer much to regain their traditional agrarian support. The strength of the farmer is only the strength of a minority, but it is a minority which has become aware of its strength and has learned to bargain effectively in advancing its welfare.

4. The Problem of Pressure Politics

The organization of economic interests to influence public policy has increased in scope and intensity with the expansion of governmental authority in the economic realm. Pressure politics has become an inextricable part of the American system of representation; the result has been to create what Walter Lippmann has called "a polity of pressure groups."

Many have expressed concern lest the tendency of organized groups to put primary emphasis on their own economic interests lead to a dispersive type of group utilitarianism which completely loses sight of the general welfare and transforms the political arena into a "battle royal of interests." That this danger is real need not be denied. Its very existence emphasizes the need of synthesis and adjustment through the machinery of the democratic process.

Chapter Three. THE LEGAL AND CONSTITUTIONAL FRAMEWORK

Together with the underlying economic development of a nation, the ideologies of its people, and the political forces directing its development, constitutional machinery is a further basic conditioning factor determining the role of government in the economic order. Law is always the prime instrument of public policy. It is the medium through which government makes its impact upon particular phases of individual and social life. The mode of legislation, administration, and adjudication shapes the forms of law and in so doing modifies its substance. Through the institutions of a written constitution and judicial review, American governmental activities are colored with a heavy tint of legalism.

In the era before the Civil War, government influence on economic life made itself felt largely through adjudication in the courts of private rights and duties. Common law and rules of equity were the touchstone of decision more often than statutes. Through this machinery, supplemented but meagerly by positive administrative action, government provided the formal context for the old economy. Orderly enforcement of private contracts was the system's keystone. In a handful of extreme instances, enforcement was refused as against public policy; but, for the most part, reliance was placed on individual self-interest as the surest guarantee of common welfare. Where social action was essential to the release of individual energies, it was provided. Establishment of a currency medium, mitigation through bankruptcy procedure of the stifling effects of insolvency, and encouragement to originality through

limited legal patent and copyright monopolies all helped to provide an institutional framework for economic development.

With the growth of those public economic activities, promotional, regulatory, planning, and operating, which form the topic of this study, the machinery of government was radically transformed. Courts were no longer the chief instruments for the application of policy. Its typical expression was in statute rather than common law, and it depended for effectuation upon a huge and complex administrative apparatus. In the states, frequent constitutional revision permitted periodic overhauling of the governmental structure. But the federal Constitution retained with few alterations the phraseology of 1787. Both the shift of balance between state and federal units and the internal transformation within the federal system occurred wholly within the framework of that document. The handful of constitutional amendments played a minor role in this respect. The adaptation was achieved in part by informal adjustment through extralegal party organization, in part by expansion of the executive establishment, but above all by judicial reinterpretation of the Constitution itself. The process on occasion progressed smoothly and rapidly, at other times haltingly and incompletely. At all times it left its characteristic mark on the developing forms and substance of governmental economic activities.

1. Constitutional Machinery and Economic Policy

The American Constitution was framed when doctrines of economic liberalism were making their most vigorous thrust for acceptance. At the same time, the bitter experience of the previous decade had demonstrated the need for increased cohesion among the states. The authors sought above all to give to the central government those elements of authoritative strength which the impotent regime under the Articles of Confederation had proved essential. In pursuing this objective they were limited by the needs of state consent. The closeness of the ratification battle and the imposition of the first ten amendments as a condition of acceptance indicate that the document as written marked the utmost possible limit of federal centralization at the time.

Correlative with this primary purpose was the desire to withdraw from the states the means of disturbing the economic conditions which to the fathers appeared essential to healthy individual en-

terprise. Centralization of power over currency and prohibitions upon state legal tender laws, upon impairment of the obligation of contracts, and upon barriers to interstate trade marked the achievement of this objective. It was implemented by provision for review of state legislation in the federal courts.

Within the central government, finally, although strength was desired vis-à-vis the states, every effort was made to provide mechanical checks to the "tyranny of faction" or the "tyranny" of any branch of the government. Madison, in urging acceptance of the document by the voters of New York, assured them that they were safeguarded not only from "the overgrown and all-grasping prerogative of an hereditary magistrate," but also from "the danger from legislative usurpation, which, by assembling all power in the same hands, must lead to the same tyranny as is threatened by executive usurpation." [1] The intricate apparatus of the separation of powers and checks and balances was consciously intended to make strong government difficult. In a system of thought which viewed government action and individual liberty as mutually exclusive spheres, an increase in the one necessarily diminishing the other, constitutional machinery was naturally designed to create a presumption against enlargements of the role of government. The concept that public action might, by restraining nongovernmental coercions, contribute positively to individual liberty had yet to make its appearance.

Under these circumstances the process of readjustment to meet altered conditions and responsibilities was focused in two areas. The pattern of the division of power between the states and the union was shifted to match the underlying developments in the economic structure. At the same time, the operating mechanisms of the central government were revised to meet the new responsibilities imposed upon it.

THE STATES AND THE UNION

The legal distribution of powers between the states and the union remains largely what it was in 1789. It controls today the relations of government to 130,000,000 people, spread from the Atlantic to the Pacific, in the same terms it applied then to 3,500,000 people confined between the Eastern seaboard and the Appalachians. In the late eighteenth century, sailing vessels along the coast provided

[1] *The Federalist*, Number 48, Everyman ed., 1911, p. 252.

the most rapid means of transportation between Eastern urban centers. The land journey from Boston to New York, over the best road in the country, took a week; that from Philadelphia to Pittsburgh, twenty days. The effect of local isolation upon political attitudes is well summarized by A. J. Beveridge:

> Community consciousness showed itself only in the more thickly peopled districts, and even there it was feeble. Generally speaking and aside from statesmen, merchants, and the veterans of the Revolution, the idea of a National Government had not penetrated the minds of the people. They managed to tolerate State Governments, because they always had lived under some such thing; but a National Government was too far away and fearsome, too alien and forbidding for them to view it with friendliness or understanding. The common man saw little difference between such an enthroned central power and the Royal British Government which had been driven from American shores.[2]

Rapid and inexpensive transportation, first provided through the railroad and later supplemented by the automobile and the airplane, together with almost instantaneous communication, was the basic factor transforming our economy from a congeries of local systems into a single national whole. The entire nation, or regions comprising large blocs of states, became the effective areas of economic and social activity. This change not only produced an enormous expansion in governmental functions; it also necessarily shifted the relations between the federal government and its component units out of all resemblance to their original condition. The direction was almost unexceptionably toward the center. For political authority, to be effective, must in the long run be organized over areas as broad as the problems with which it deals.

The growth of federal authority is in no sense a very recent phenomenon. Noticeable before the Civil War, it reached a rapid rate of expansion toward the end of the nineteenth century. It took two forms: direct extension of federal power and employment of the states as instruments of federal policy. For the most part, federal intervention in new fields occurred only after corresponding state efforts proved inadequate. The state Granger laws of the eighteen-seventies were unable to cope with railroad regulation; they were supplemented by the Interstate Commerce Act of 1887. State antitrust laws likewise fell short of their objectives; in this field federal legislation began in 1890. Protection against adulterated

[2] A. J. Beveridge, *The Life of John Marshall*, 1916, Vol. I, p. 285.

food and drugs, provided in part by the states throughout the nineteenth century, was assumed as a federal responsibility in 1906. After the first World War, the increasing importance of interstate transmission of electric power and natural gas, together with the organization of public utility holding companies on a superstate scale, engendered federal participation in these spheres. Protective labor legislation, until recently a matter solely of state concern, is likewise passing into the arena of federal jurisdiction. Only in rare instances, such as the control of radio communications and bituminous coal, has the federal government initiated regulation without prior action by the states.

The supplanting of state by federal action in the most important fields of regulation was not the product of any widespread desire for federal centralization as such. It was adopted by Senators and Congressmen drawn from state areas, who were loath, on principle, to diminish the relative influence of the states. Sometimes it followed a Supreme Court decision denying to the states constitutional authority over particular objects of regulation. More often, however, the need for federal intervention was a product of inherent state limitations based upon disharmony between the areas of political and economic organization.

When markets expand beyond state boundaries, no state can afford to impose regulatory or protective requirements upon its enterprises far out of line with those of its neighbors. To do so presents to its entrepreneurs the alternative of bankruptcy or transfer of their businesses to states exacting less stringent conditions. Interstate competition is a potent pressure toward lower standards. Only a uniform rule can resolve this dilemma. In a handful of cases such rules have been provided through interstate compacts. But, in the main, federal centralization has appeared to be the only feasible solution.

Extension of federal policy through state instrumentalities was, until recently, accomplished chiefly through grants-in-aid. Federal funds or federal lands were given to the states for particular purposes under specified conditions of state co-operation. In this way, objectives close to the heart of Congress, but not clearly within the scope of the constitutional grant of powers, were accomplished on a nation-wide scale. Agricultural and vocational education and road building are the classic examples. More recently, federal funds have been used to supplement the depleted resources of states and

municipalities in order to maintain a national minimum of unemployment relief.

The Social Security Act of 1935 marked a further milestone in the evolution of this new co-operative federalism. It followed the older model of grants-in-aid for benefits to the aged, the disabled, and the blind, but employed a new technique for unemployment insurance.[3] State-administered and state-financed systems, subject to minimum federal standards, but with a very wide degree of local discretion, are virtually required by federal law through the imposition of a substantial tax upon employers in states failing to comply with the Act. Portions of the New Deal agricultural program have also been based on this type of federal-state relationship. In addition, the federal government has begun to develop, through the public works program and other channels, direct relations with cities and other local units, theoretically creations of the states but frequently possessing a more vital community life than their legal parents.

While state functions are drawn increasingly into the federal vortex because so many economic problems extend beyond state boundaries, the appropriate area of jurisdiction is often neither the individual state nor the nation as a whole. The natural geographical influences which promote community of economic interest tend to produce within the United States a typically regional pattern. The federal system, if recreated *de novo* at the present day, would probably follow the Canadian and Australian models in adopting far larger units than those inherited from the past. The suitability of particular areas varies for different purposes; over one hundred different subdivisions are used today in federal administration. In addition to federal administrative districts, regional political authorities have been constituted in two ways: from the bottom up through interstate compact and from the top down through such federal agencies as the Tennessee Valley Authority. Abandonment of our present states in favor of regions is hardly to be expected, except possibly as a far distant reaction against extreme federal centralization. Nevertheless, the effort to transform recognition of

[3] A precedent for the tax offset device of the Social Security Act had been established in the federal inheritance tax law of 1926, which allowed taxpayers to credit state inheritance tax payments against the federal tax, up to 80 per cent of the latter. The constitutionality of this measure was unanimously sustained by the Supreme Court in *Florida* v. *Mellon*, 273 U.S. 12 (1927).

regional interests and consciousness into responsible regional administration marks a significant and expanding phase of the new federal relationship.

A problem of particular difficulty in state-federal relations is presented by state efforts to improve their relative economic situation through protective, discriminatory, or retaliatory legislation. Spurred by the ravages of the Great Depression, state legislatures have poured forth so great a stream of such measures over the last decade that they threaten to destroy to a large extent that nationwide freedom of commerce which was the most signal economic achievement of the national Constitution.

Direct taxation of imports or exports by the states is constitutionally prohibited. Effects akin to those of protective tariffs, however, have been achieved through a variety of indirect devices. "Foreign" corporations have been heavily taxed for the privilege of doing business within a state. "Use taxes" have been levied on goods brought in from the outside. Preference for domestic materials is ordinarily required on public works. The administration of quarantine laws for agricultural and horticultural products imported into particular states has been so managed as to impose a heavy discriminatory burden on such products, or sometimes to exclude them altogether. Milk inspection laws have been used to the same result. Under the authority of the states to promote safety and protect the highways, legislatures have enacted a multitude of conflicting width, length, height, weight, registration, and insurance statutes for trucking, which constitute a serious obstacle to interstate freight movement on the roads. A quarter of the states have established "ports of entry" at specified border points, where quarantine and trucking laws are enforced.

The net effect of this trade barrier movement is viewed by some observers as rivaling in its implications the destructive commercial warfare experienced under the Articles of Confederation. Some of its most extreme manifestations have been curbed by judicial application of the prohibition on state tariffs and of implied limitations on obstructions to interstate commerce drawn from the terms of the commerce clause. But the Supreme Court has in recent years been reluctant to intervene in the absence of positive Congressional action. Through the leadership of the Council of State Governments, an agency for co-operative state action, which has strongly condemned the growth of trade barriers on principle, a number

of mitigating measures have been enacted. Experiments in joint federal-state inspection promise some relief in the agricultural field. If the trend is to be positively reversed, however, federal legislation will probably be essential.

THE SEPARATION OF POWERS

Adjustments to evolving needs of public policy within the machinery of central government, while less extensive than the altered distribution of federal-state authority, have also been very far reaching. They include measures to overcome hindrances to effective governmental action imposed by the separation of legislative, executive, and judicial powers, and the creation of new types of administrative agencies outside the traditional trichotomy. The assumption of policy leadership by the President, operating through political party machinery, goes far to transcend the division between legislature and executive. Pressures of organized interest groups are felt alike by Congressman and administrator; they often serve to ensure harmony in particular realms between the two branches. Moreover, as regulatory policy becomes increasingly complex, statutes are often enacted in general terms, leaving to administrators and to the courts a potent share in the legislative process. Thus the gaps separating the branches of government are bridged at many points.

In this connection, the outstanding innovation in governmental machinery is the administrative commission. Originally developed for railway regulation in a few states, this form was first adopted for federal regulatory purposes with the creation of the Interstate Commerce Commission in 1887. It is now a common device for implementation of federal policy and the almost uniform means of state public utility regulation. It may be viewed, indeed, as the characteristic, although by no means exclusive, American instrument for specialized regulation.[4]

Independent of the ordinary executive structure, endowed with security of tenure for substantial terms, and acting under broad grants of legislative authority, administrative commissions solve the dilemma of the separation of powers by performing the functions of all three traditional types. They serve as legislators in fill-

[4] The public corporation, the use of which has been enormously expanded during the last decade, promises to become similarly the characteristic instrument of public enterprise. Its salient features are treated in Chapter 19.

ing in the terms of general statutory standards, as administrators in actively promoting on behalf of the public the policies entrusted to them by Congress, and as judges in applying those policies to particular cases. This fusion of functions, together with the relative independence of the commissions from Presidential control, has occasioned alarm in some quarters. In 1937, President Roosevelt's Committee on Administrative Management described them as "a headless 'fourth branch' of the government, a haphazard deposit of irresponsible agencies and un-co-ordinated powers. . . . The Congress has found no effective way of supervising them, they cannot be controlled by the President, and they are answerable to the courts only in respect to the legality of their actions."

Criticism of this type is based on two quite distinct premises. One is the hypothesis that all decisions of administrative policy must be made on the responsibility of a co-ordinated administrative hierarchy of pyramidal form, with the President at the apex. The second sees in the fusion of lawmaking, prosecuting, and judging functions an elementary contradiction of legal principles at the heart of the Anglo-American tradition.

It is evident that in setting up independent agencies with staggered terms of five to seven years Congress hoped to introduce into administration, in these special fields, a degree of continuity of policy impossible under an all-embracing and unified system of Presidential responsibility. The influence of changes in public sentiment as reflected at the polls is not wholly destroyed; in this respect the independent commission stands midway between ordinary departments and the courts. The device produces in limited areas of the American administrative structure a continuity of service and policy comparable to that derived abroad from permanent tenure of high-ranking civil servants. On the other hand, it suffers from the disadvantages of non-co-ordination with other agencies in related areas. Whatever the merits of the matter, the response of Congress to the report indicates that, for the present, the Committee's recommendation that all commission functions be divided between an administrative section, subject to the ordinary controls of a Cabinet Department, and a semi-independent judicial section, is not likely to be adopted.[5] Proposals for limiting the exercise of

[5] Under the Reorganization Act of 1939, the President abolished the National Bituminous Coal Commission in favor of a Bituminous Coal Division within the Interior Department, and transferred part of the functions of the Civil Aeronautics Authority

quasi-judicial functions through extended judicial review are considered at a later point in this chapter.

Despite extensive reorganization and the development of special administrative instruments for particular purposes, the federal government remains an enormously complex and cumbersome machine. Its greatest weakness lies in the obstacles presented by its very structure to effective co-ordination, both in policy making and in administration. The essential role played by special interest groups in any democratic society is magnified by the structural characteristics of the American system. Frequent election of members of Congress from relatively small territorial districts, combined with the generality of party programs and the looseness of party discipline, lays the federal legislature peculiarly open to effective manipulation by organized pressures.

Parties serve to integrate special interests into national policies only to a limited degree. Legislative leadership from the President, the sole officer of government elected from a nation-wide constituency, depends upon the weak constitutional instrument of the veto, supplemented by the only slightly more potent extraconstitutional devices of patronage, party influence, discretionary allocations of federal funds, and direct appeals to the electorate. The national budget system, established in 1921, is an important aid to fiscal and administrative planning, but leaves the center of gravity of policy decisions in the halls of Congress. Permeation of the dynamics of policy formation and administration by the influence of organized interests will be observed in every sphere of government activity treated in this work.

JUDICIAL REVIEW

The watchful eye of the Supreme Court has attended every stage in the transformation of government's relation to economic life from the modest role that it played in 1789 to the all-pervasive functions of today. Judicial review, applied to state activities by the explicit terms of the Constitution, and to federal activities by the doctrine established in 1803 in *Marbury* v. *Madison,* is an integral element in the process of readjustment. The unique power of our courts casts the great issues of American public policy into the

to the Commerce Department. It is noteworthy, however, that in granting authority for executive reorganizations Congress specifically forbade the abolition, consolidation, or transfer of almost all the federal regulatory commissions.

mold of constitutional law. Considerations of intrinsic desirability have often been subordinated to, or treated in terms of, the tests of "interstate commerce" or "due process of law."

The very existence of constitutional limitations has made the courts more ready to reshape the meaning and application of statutes, even when constitutional issues are not directly involved. Alexander Hamilton foresaw such judicial participation in the legislative process. In 1788, he wrote:

> But it is not with a view to infractions of the Constitution only that the independence of the judges may be an essential safeguard against the effects of occasional ill humours in the society. These sometimes extend no farther than to the injury of the private rights of particular classes of citizens by unjust and partial laws. Here also the firmness of the judicial magistracy is of vast importance in mitigating the severity and confining the operation of such laws. It not only serves to moderate the immediate mischiefs of those which may have been passed, but it operates as a check upon the legislative body in passing them; who, perceiving that obstacles to the success of iniquitous intention are to be expected from the scruples of the courts, are in a manner compelled, by the very motives of the injustice they meditate, to qualify their attempts.[6]

The influence of judicial review on specific phases of policy making and administration will be a recurrent theme of the present study. We may take the opportunity here, however, to review briefly the historic role of the Supreme Court in the growth of economic policy, and to summarize analytically the major categories of constitutional limitations.

2. Constitutional Limitations on Economic Policy

CONSTITUTIONAL LAW AND ECONOMIC DEVELOPMENT

The nature of the judicial process applied to constitutional interpretation gives to the courts a wide area of discretion within which to guide and confine the evolution of policy. The expansibility of the crucial phrases of the Constitution is amply proven by their adaptation to a wholly altered technological and social environment. Adherence to the rule of *stare decisis* does not substantially diminish the flexibility of judicial decision. No two cases are identical, and interpretation over a century and a half has given to the

[6] *The Federalist*, Number 78, Everyman ed., 1911, pp. 399–400.

courts an ample fund of precedents on both sides of every leading issue. The Supreme Court, moreover, has never held itself rigidly bound by decisions of the past. Precedents are occasionally explicitly overruled in the light of changed circumstances; more often they are abandoned *sub silentio*.

The judicial role in policy formation is essentially negative. The Supreme Court is, in a sense, a "third House" of all our legislatures, state and national, but its power is one of veto rather than origination. Measures which are clearly constitutional do not receive its consideration, for it acts only when a bona fide controversy is brought before it. The great epochs of judicial supremacy are those in which new restrictions are imposed upon legislators and administrators. Each holding of unconstitutionality, moreover, may strike down a host of similar measures and smother in embryo the initiation of others. Thus future policy is diverted into permitted channels and means of administration confined within the orbit of judicial approval. In periods of liberality, the courts may perform an essential function in sweeping away the earlier bounds; they cannot determine the shape of things to come.

In setting the constitutional framework for economic development and correlative governmental responses, five great eras are discernible in Supreme Court history. From 1801 to 1835, the leadership of Chief Justice Marshall established a broad scope of national power within which the expanding economy might develop. Only one act of Congress was invalidated, an unimportant section of the Judiciary Act of 1789, but the opportunity was used to affirm the Court's authority over federal legislation.[7] Above all, Marshall announced in ringing words a sweeping interpretation of the commerce clause, laying a foundation for its use not merely as the major vehicle of later federal regulation, but also as a potent limitation upon the states.[8] Threats by the states to national economic expansion were sternly struck down. The constitutional phrase which forbade state laws "impairing the obligation of contracts" became a powerful weapon against legislation considered inimical to individual enterprise.

Under Chief Justice Taney, who held office from 1836 to 1864, the Court maintained the basic lines of interpretation thus established. In this period also only a single federal statute fell under

[7] *Marbury* v. *Madison*, 1 Cranch 137 (1803).

[8] *Gibbons* v. *Ogden*, 9 Wheaton 1 (1824).

the judicial ax;[9] and while the decision was the most ill fated in American history, it was irrelevant to the considerations of economic policy which concern us here. The commerce clause remained a broad foundation for federal authority. The Court was now less willing, however, to construe it as a limitation upon the states in fields where Congress had not taken positive action. State regulatory action was viewed more kindly. The contract clause was less severely applied. The battle between President Jackson and the United States Bank, in which Taney, as Secretary of the Treasury in 1833, had played a leading part, left him fearful of the growing power of monopoly, particularly financial monopoly. This experience was reflected in his decisions. But, notwithstanding important alterations in approach, judicial limitations under his guidance continued to follow the currents set flowing by Marshall.

In the third era, from the Civil War until 1885, the Court was concerned primarily with problems arising out of the war and postwar reconstruction. The states were then making their first groping efforts toward tempering the more egregious evils of the new industrialism. At first, the Court's reaction favored legislative discretion. In the celebrated *Granger* decisions of 1877, it refused to disapprove legislative regulation of grain elevators and railroads as in conflict with the recently adopted Fourteenth Amendment. Utmost leeway was given the states in the exercise of the "police power," their broad authority to protect the public morals, the public safety, the public health, and the public welfare. "We know," said Chief Justice Waite, "that this is a power which may be abused; but that is no argument against its existence. For protection against abuses by legislatures the people must resort to the polls, not the courts."[10]

Beginning in the middle eighties, however, and continuing for a full half century, the Court revised its constitutional interpretations to constitute itself the chief barrier to government activity in the economic order. As this period coincided with the upsurge of pressures for limitation of corporate freedom in the interest of disadvantaged groups, constitutional limitations became an all-important element in the making of policy. The meaning of the commerce clause was narrowed to prevent federal regulation in certain areas

[9] The Missouri Compromise of 1820, in *Dred Scott* v. *Sandford*, 19 Howard 393 (1857).

[10] *Munn* v. *Illinois*, 94 U.S. 113 (1877).

where economic necessities made federal action alone possible. But the major instrument of restraint was the phrase "due process of law" in the Fifth and Fourteenth Amendments. From a procedural limitation, orginally designed to prevent federal encroachment upon individual rights and extended into the states to protect the Negroes of the South, the clause was transformed into a substantive limitation upon any social or economic legislation which, in the eyes of the Court, appeared unreasonable, arbitrary, or capricious. Its protection of "persons" was extended to corporations. Its prohibition upon deprivations of liberty and property was construed to enact into the Constitution the classical economic doctrines of laissez faire and of liberty of contract.

A consistent application of these restraints over the entire fifty years is not to be looked for. There were always dissenting voices. The term of the radical Republican Justice Harlan, who inveighed mightily against what he called "judicial usurpation of legislative authority," overlapped with that of the liberal Justice Holmes, who pled consistently for free legislative experimentation in the states. At intervals their views prevailed. In the decade preceding our entry into the first World War, particularly, a new charter of freedom was given to protective labor legislation and corporate regulation. Accidents of individual appointments and tenure played no small part in turning the balance of decision in close cases. During the half century as a whole, however, the dominant motif was expressed in the viewpoints of Justices Field, Brewer, McKenna, and Sutherland. They held it their duty to protect the rights of private property and corporate freedom against what seemed to them unwarranted encroachments of radical democracy upon the true liberalism of unhampered individual enterprise.

The fourth era ended with the constitutional crisis of 1937. Invalidation, in turn, of a series of leading New Deal measures—the National Industrial Recovery Act, the Agricultural Adjustment Act, the Bituminous Coal Conservation Act, the Railroad Retirement Act, the Frazier-Lemke Farm Mortgage Act, and the Municipal Bankruptcy Act—together with the reaffirmation of the unconstitutionality of state minimum wage legislation, convinced the President that existing modes of constitutional interpretation presented insuperable obstacles to his program. His effort to cut the Gordian knot by enlarging the size of the Court was defeated after a titanic Congressional struggle. The Court itself, however, without

alterations in personnel, resolved the dilemma by revising the trend of interpretation on three critical lines. The barrier to increased federal authority was removed by reinterpretation of both the commerce and the general welfare clauses. The due process clause was shorn of its restrictive character. Within two years, five judges had been replaced, and the more liberal viewpoints were apparently crystallized as the attitude of the Court for a long period to come. Judicial self-restraint has been the kernel of this attitude. No federal statutes have been invalidated since 1937. While state encroachments upon civil liberties have been more vigorously resisted by the Court than ever before, it has ceased to discourage social and economic experimentation. It has constantly reiterated its new-found conviction that the policy-making function belongs with the elected representatives of the people.

In the course of this long history of judicial review, two major categories of substantive limits to economic policy were established. The grant of powers to the federal government was at times so narrowly construed as to forbid Congressional action. The requirement of due process of law was applied alike to both the nation and the states.

LIMITATIONS ON FEDERAL AUTHORITY

It is a basic feature of our constitutional system that federal authority is limited to the enumerated powers. A number of important economic measures of the federal government have been hung on the constitutional pegs of its powers over currency, patents and copyrights, and bankruptcy. But the vital sources of federal authority are the powers to regulate interstate and foreign commerce and to impose taxes and spend federal funds in the general welfare.

The trend of interpretation of the commerce clause has been, by and large, one of continuous extension, paralleling the transformation in scale of economic activities. By the earliest interpretation of this clause, "commerce" was held to include transportation as well as trading across state lines. New methods of communication were also readily included within its scope. Economic realities and legal adjustments, however, have not always moved in step. In Marshall's hands, the commerce clause was made an instrument for the release of enterprise from state restrictions. But in the late nineteenth and twentieth centuries, when federal limitations first began signifi-

cantly to rival those of the states, the Court became fearful of too wide an extension of its scope.

The interpretation of the commerce clause was developed, in consequence, in two contrasting directions. On the one hand, federal regulation viewed as desirable was permitted to extend even into the domain of nominally intrastate affairs. Two doctrines were evolved for this purpose. The first extended federal authority to intrastate activities "affecting" interstate commerce, while the second viewed certain intrastate operations as elements in a continuous "stream" of interstate commerce. The *Shreveport* case, decided in 1914, permitted federal control "in all matters having such a close and substantial relation to interstate traffic that the control is essential or appropriate to the security of that traffic, to the efficiency of the interstate service, and to the maintenance of conditions under which interstate commerce may be conducted upon fair terms and without molestation or hindrance." [11] The concept of a "stream" of interstate commerce was introduced in 1922 in a decision [12] sustaining federal regulation of stockyards. This concept might likewise be employed to bring manufacturing or processing operations within the scope of federal regulation.

On the other hand, regulatory action viewed askance by the Court could be struck down through the doctrine of "dual federalism." Under this principle, the "normal" authority of the states over production, as contrasted with commerce proper, became an independent limitation on federal authority. Antitrust policy was in this way denied application for a time to the very manufacturing combinations which it was designed to combat, on the grounds that their operations were matters exclusively of state concern.[13] The federal effort to prohibit interstate commerce in the products of establishments employing child labor was similarly frustrated.[14] There was thus created a "twilight zone" between federal and state authority. In this area states were unable to provide effective regulation, because of either legal restraints or the pragmatic economic limitations of interstate competition, while at the same time federal regulation was forbidden by the Court.

In the early days of the New Deal this "twilight zone" was ex-

[11] *Houston, East and West Texas Railway Co.* v. *United States,* 234 U.S. 342 (1914).
[12] *Stafford* v. *Wallace,* 258 U.S. 495 (1922).
[13] *United States* v. *E. C. Knight Co.,* 156 U.S. 1 (1895).
[14] *Hammer* v. *Dagenhart,* 247 U.S. 251 (1918).

tended through a narrowing redefinition of the *Shreveport* doctrine. It was held that in order to bring production or intrastate commerce within the federal jurisdiction a "direct effect" upon interstate commerce must be shown, not merely a "close and substantial effect." The new limitation contributed to invalidation of the National Industrial Recovery Act and was the major ground for disapproval of the Bituminous Coal Conservation Act.

> The word "direct" [said Justice Sutherland in stating the majority opinion] implies that the activity or condition invoked or blamed shall operate proximately—not mediately, remotely, or collaterally—to produce the effect. It connotes the absence of an efficient intervening agency or condition. And the extent of the effect bears no logical relation to its character. The distinction between a direct and an indirect effect turns not upon the magnitude of either the cause or the effect, but entirely upon the manner in which the effect has been brought about.[15]

This limited view of the national power, in striking contrast with more generous interpretations of the past, was probably the primary element in President Roosevelt's decision to seek resolution of the constitutional crisis by an alteration in Court personnel. The National Labor Relations Act cases, decided in 1937, sharply reversed the constricting tendency of the immediately preceding interpretations. The verbal test bringing intrastate activities within the scope of the commerce clause now became a "close and intimate effect" rather than a "direct effect." For a mechanical and legalistic criterion of proximity or remoteness there was substituted a realistic analysis of substantiality.[16] In subsequent decisions the Court has been prone to give to federal authority the benefit of any doubt. One of the first Labor Board cases sustained the Board's jurisdiction over a clothing manufacturer doing only an insignificant proportion of the total interstate business. A year later the Board was upheld in an order against a fruit-packing company obtaining all its raw materials within a single state and exporting only 37 per cent of its total products.[17] Shortly thereafter the commerce clause

[15] *Carter* v. *Carter Coal Co.*, 298 U.S. 238 (1936). The NIRA decision is reported as *Schechter* v. *United States*, 295 U.S. 495 (1935).

[16] *National Labor Relations Board* v. *Jones & Laughlin Steel Corporation*, 301 U.S. 1; *NLRB* v. *Fruehauf Trailer Co.*, 301 U.S. 49; *NLRB* v. *Friedman-Harry Marks Clothing Co.*, 301 U.S. 58; *Associated Press* v. *NLRB*, 301 U.S. 103 (1937).

[17] *Santa Cruz Fruit Packing Co.* v. *National Labor Relations Board*, 303 U.S. 453 (1938).

was held to give it jurisdiction over the Consolidated Edison Company of New York, which made no sales beyond the state, on the ground that vital interstate railroad, shipping, communications, and commercial services depended upon its operations.[18]

Not merely the extent of federal jurisdiction under the commerce clause, but also its qualitative scope have been given the utmost breadth in recent decisions. Promotion, protection, fostering, if need be prohibition of commerce, are all within its terms. A recent decision sustaining the authority of the Federal Power Commission over hydroelectric developments on navigable waters illustrates its amplitude. In the words of Justice Reed, speaking for the Court:

> In our view, it cannot properly be said that the constitutional power of the United States over its waters is limited to control for navigation. By navigation respondent means no more than operation of boats and improvement of the waterway itself. In truth the authority of the United States is the regulation of commerce on its waters. Navigability, in the sense just stated, is but a part of this whole. Flood protection, watershed development, recovery of the cost of improvements through utilization of power are likewise parts of commerce control. . . . That authority is as broad as the needs of commerce.[19]

At the same time, the revived devotion to the precepts of judicial self-restraint has led the Court to uphold state measures substantially affecting or even seriously restraining interstate commerce, in the absence of Congressional pre-emption of the particular field of action.[20]

The second great constitutional vehicle of federal centralization, rivaling the commerce clause in importance, is the power to tax and spend in pursuance of the general welfare. The use of taxes as a regulatory device has a checkered judicial career. With a few striking exceptions, regulation through taxation has been permitted only as an alternative means of accomplishing objectives which might have been sought directly under some other enu-

[18] *Consolidated Edison Co.* v. *National Labor Relations Board,* 305 U.S. 197 (1938).

[19] The "New River Case," *United States* v. *Appalachian Electric Power Co.,* 61 S.Ct. 291 (1940).

[20] See, for example, *Ford Motor Co.* v. *Beauchamp,* 308 U.S. 331 (1939); and *McGoldrick* v. *Berwind-White Coal Mining Co.,* 309 U.S. 33 (1940). For a closely divided opinion turning the other way, see *McCarroll* v. *Dixie Greyhound Lines,* 309 U.S. 176 (1940).

merated power.[21] The promotion of various national objectives through the use of federal funds, however, and the use of such funds to induce state participation in federally aided programs, for decades went untested in the courts.

The classic rival interpretations of the general welfare clause by Hamilton and Madison, the one espousing a broad interpretation and the other demanding its limitation to federal objectives otherwise enumerated, need not be reviewed here. In practice, Hamilton's view has been accepted by Congress. The policy of nationally financed internal improvements has gone far beyond the promotion of interstate commerce. Not only waterways, railroads, and roads, but education, agriculture, maternity welfare, and a host of other services have come within its orbit. It has been difficult to obtain from the Court a definitive interpretation of the general welfare clause, since beneficiaries were unlikely to contest the power while individual taxpayers were held without sufficient interest to justify restraining suits. An astute constitutional commentator, Edward S. Corwin, concluded in 1934 "that the success of the spending power in eluding all constitutional snares goes far to envelop the entire institution of judicial review, as well as its product, constitutional law, in an atmosphere of unreality, even of futility." [22]

A method was finally found, in 1936, to obtain an expression of Supreme Court opinion on this power, in connection with the Agricultural Adjustment Act of 1933.[23] While the majority nominally accepted Hamilton's broad interpretation, it applied as an independent limitation the same doctrine of "dual federalism" which for a time was used to emasculate the commerce clause. Agriculture was held to be production, and thus within the "normal" area of state jurisdiction. The federal government was forbidden to employ the spending power to regulate indirectly a subject not amenable to its direct regulation. Here, too, the path of federal authority was reopened in 1937. In the *Social Security* cases both a direct federal system of old age benefits and a federally instigated system of state unemployment insurance were sustained as legitimate ex-

[21] The major exception was approval of a prohibitory tax on oleomargarine when colored to resemble butter, in *McCray* v. *United States*, 195 U.S. 27 (1904). The Court there refused to go behind the fact that the measure on its face was one of taxation rather than regulation. While never explicitly overruled, this doctrine was subsequently abandoned.

[22] *The Twilight of the Supreme Court*, pp. 178–179.

[23] *United States* v. *Butler*, the "Hoosac Mills Case," 297 U.S. 1 (1936).

ercises of the taxing and spending power.[24] The Court took notice of the obstacles to individual state action imposed by competition among the states. Co-operative endeavor by the states and union to attack a situation injurious to both was explicitly approved.

Issues of jurisdiction arising out of the federal structure of our government remain a modifying influence on public economic policy, but their importance is minimized for the time being by the amplitude of the Court's interpretation of federal authority. The Court is still the umpire of the system in cases of outright conflict. But it has returned to the legislatures, federal and state, the task of determining the most appropriate distribution of governmental functions.

DUE PROCESS OF LAW

Correlative with the "twilight zone" falling between effective state and effective federal economic action, judicial interpretation has evolved a "midnight zone" into which, by specific constitutional inhibition, the economic policy of neither states nor union may extend. The major source of these restraints is the identical language of the Fifth and Fourteenth Amendments protecting any person against deprivation of life, liberty, or property without due process of law.[25] During the first century of interpretation of the due process clause, as part of the Fifth Amendment, it was construed solely as an additional procedural protection for private individuals, which in most instances could be claimed under the more specific terms of other portions of the Bill of Rights. Until 1886, moreover, the Court consistently refused to extend the Fourteenth Amendment beyond the purposes for which it had ostensibly been adopted, i. e., the protection of Negroes against discrimination.[26]

[24] *Steward Machine Co.* v. *Davis,* 301 U.S. 548; *Helvering* v. *Davis,* 301 U.S. 619 (1937).

[25] The associated phrase in the Fourteenth Amendment prohibiting denial of "the equal protection of the laws" is also an important limitation on discriminatory state legislation.

[26] In an oral argument before the Supreme Court in 1882, Roscoe Conkling, a member of the Congressional Committee which had drafted the Fourteenth Amendment, showed from the contents of the then unpublished Committee Journal that possible application of the Amendment to corporate protection had been considered at the time. This interpretation, however, played no part either in Congressional adoption of the Amendment or in its ratification by the states. It was nevertheless later employed by the Court in justifying its altered construction of the due process clause.

A new Court majority in the middle eighties drastically altered this interpretation. Corporations as well as natural persons were brought within the scope of the clause. Its words became a medium for judicial review of any legislation affecting private rights. It became a limitation upon the police powers of the states so that, while they might still legislate for the public health, morals, safety, and welfare, any restriction on private or corporate freedom in so doing was subjected to judicial censorship. If, in the eyes of the Court, the legislative purposes in question were unwarranted, the means not appropriate to a justifiable purpose, or the expression of policy discriminatory, arbitrary, unreasonable, or capricious, the statute failed of approval. Within the federal field of activity, moreover, Congressional action was similarly constrained.

In the first quarter century of the new interpretation the Court adopted an extreme stand against interference with private rights and duties for social ends. Protective labor legislation was a leading, but not the sole, type of policy to fall under the judicial ban. The theoretical presumption of constitutionality was not reflected in actual decisions. A mechanical application of the doctrine of freedom of contract, regardless of social and economic realities of unequal bargaining power, was the guiding principle of adjudication. In a celebrated dissenting opinion of 1905, Justice Holmes protested against embodiment in the Constitution of a "particular economic theory." "The Fourteenth Amendment," he declared, "does not enact Mr. Herbert Spencer's *Social Statics*." [27]

For a few years after 1910, the Court retreated to some extent from this stand. Important inroads were made upon the more extreme manifestations of judicial faith in laissez faire, particularly in the areas of special protection for women and of general limitations on hours of work. In this process the use of economic briefs, elaborating in detail upon the practical effects of the absence of regulation, was a powerful device in forcing actuality upon the Court's attention. In addition, political hostility to the judiciary, and growing demands for power to recall judicial decisions, doubtless also contributed to the result. In the postwar period, however, a more conservative attitude again dominated due process decisions. Minimum wage legislation for women and children became the focus of dispute. Measures of this type were repeatedly rejected

[27] *Lochner* v. *New York*, 198 U.S. 45 (1905).

from 1923 until 1936, although generally by a closely divided Court.[28]

As in other areas, the year 1937 marked the beginning of a new era in interpretation of the due process clause. The earlier minimum wage decisions were explicitly overruled.[29]

> The Constitution [wrote Chief Justice Hughes] does not speak of freedom of contract. It speaks of liberty and prohibits the deprivation of liberty without due process of law. In prohibiting that deprivation, the Constitution does not recognize an absolute and uncontrollable liberty. . . . The liberty safeguarded is liberty in a social organization which requires the protection of law against the evils which menace the health, safety, morals and welfare of the people.

The Court took judicial notice of the economic effects of the Great Depression. It recognized the necessity for development of the police power in accordance with changing economic needs.

In the field of industrial regulation, the due process clause was employed during the period 1885–1936 both to restrict the scope of regulation and to control the regulatory process where it was permitted. Price control, in particular, for many decades was limited to businesses "affected with a public interest." This expression, tossed out almost accidentally by the Court to give historical foundation to its decisions in the *Granger* cases, threatened for a time to create an arbitrary category of particular industries peculiarly liable to public regulation, while others, despite equally compelling needs, were excluded. The category was never completely closed. In 1923, Chief Justice Taft divided it into three sections: (1) businesses carried on under public franchise, (2) businesses traditionally subjected to special regulation at common law, and (3) "businesses which, though not public at their inception, may be fairly said to have arisen to be such and have become subject in consequence to some government regulation." [30]

Classification of new industries under the category was a matter of discretion for the Court. In practice it proved a difficult task. Regulation of insurance premiums was sanctioned in 1914,[31] but

[28] The history of protective labor legislation in the Supreme Court is treated in some detail in Chapter 6.

[29] *West Coast Hotel* v. *Parrish,* 300 U.S. 379 (1937).

[30] *Wolff Packing Co.* v. *Industrial Court of Kansas,* 262 U.S. 522 (1923).

[31] *German Alliance Insurance Co.* v. *Lewis,* 233 U.S. 389 (1914).

during the postwar period the doctrine was employed to forbid in turn (1) compulsory arbitration in "essential industries," including the preparation of food; [32] (2) the regulation of theater ticket resale premiums in New York; [33] (3) limitations on the charges of employment agencies; [34] (4) price fixing for gasoline sold at retail; [35] and (5) the requirement of certificates of convenience and necessity for ice manufacture in Oklahoma.[36] Although the traditional public utility field was, of course, within the concept, this line of interpretation tended to place regulatory policy in a strait jacket, preventing experimentation in partial regulation for other industries which might well benefit from or require a limited degree of public control. Moreover, as the line was drawn in practice, it was difficult to find consistent controlling tests common to the included industries and absent from the excluded ones.

In 1934, in *Nebbia* v. *New York*,[37] the Court swept away the doctrine as a matter of principle.

> It is clear [wrote Justice Roberts for the majority] that there is no closed class or category of businesses affected with a public interest, and the function of the courts in the application of the Fifth and Fourteenth Amendments is to determine in each case whether circumstances vindicate the challenged regulation as a reasonable exertion of governmental authority or condemn it as arbitrary or discriminatory. . . . The phrase "affected with a public interest" can, in the nature of things, mean no more than that an industry, for adequate reason, is subject to control for the public good.

The *Nebbia* decision did not grant to legislatures complete freedom in choosing objects and methods of regulation. In the subsequent history of New York's efforts at milk control, out of which that case arose, further appeals were taken to the Supreme Court on several occcasions and one feature of the milk control plan was invalidated.[38]

Here again, however, the new judicial dispensation since 1937

[32] *Wolff Packing Co.* case, *supra.*

[33] *Tyson* v. *Banton,* 273 U.S. 418 (1927).

[34] *Ribnik* v. *McBride,* 277 U.S. 350 (1928).

[35] *Williams* v. *Standard Oil Company,* 278 U.S. 235 (1929).

[36] *New State Ice Co.* v. *Liebmann,* 285 U.S. 262 (1932).

[37] 291 U.S. 502.

[38] *Mayflower Farms* v. *Ten Eyck,* 297 U.S. 266 (1936). The provision in question forbade extension of a price differential to dealers entering the market after effectuation of the control program.

portends a wide area of legislative freedom. In sustaining unanimously Georgia's regulation of tobacco warehouses in 1937, the Court emphasized that "the legislature, acting within its sphere, is presumed to know the needs of the people of the state." [39] And, in the federal sphere, in upholding the Bituminous Coal Act of 1937 against contentions of its repugnance to the Fifth Amendment, the Court gave particular weight to "the judgment of Congress that price fixing and the elimination of unfair competitive practices were appropriate methods for the prevention of" the historic evils of the industry.[40]

In those areas where extensive regulation had been permitted under the due process clause, the Court retained close supervision over the regulatory process. The *Granger* case doctrine, making reasonableness of regulated prices a matter of legislative discretion, was slowly whittled away over a twenty-year period in favor of thoroughgoing judicial review. In 1898, the Court emerged as the arbiter of public utility regulation through its requirement that regulation allow a fair return on the fair value of the property.[41] The obstacles that were thus placed before utility regulators are treated in detail in Chapter 10. Suffice it to say here that judicial participation in the regulatory process through the rule of *Smyth* v. *Ames* proved a major factor in hampering the effectiveness of the administrative commission as a device of public control.

3. Constitutional Limitations on the Administration of Policy

The role of the judiciary in confining the forms and processes of administration is hardly less significant than its review of substantive policy making. The focus of public economic policy has shifted away from the common-law courts, first to direct legislative prescription and more recently to administrative agencies. From the manifold causal factors inducing this shift, two primary considerations stand out. Increased technical complexity of specific policies requires a high degree of specialization. At the same time, interests unable adequately to represent themselves, whether poorly organized special interests or the broad interest of the public as a

[39] *Townsend* v. *Yeomans*, 301 U.S. 441.
[40] *Sunshine Anthracite Coal Co.* v. *Adkins*, 310 U.S. 381 (1940).
[41] *Smyth* v. *Ames*, 169 U.S. 466.

whole, can successfully realize their objectives only with the aid of officers of government acting on their behalf.

Constitutional limitations affect the administrative process in two major respects. The doctrine of the separation of powers sets limits to the transfer of legislative and judicial functions into administrative hands. At the same time, procedural requirements of "due process" condition the mode of administration wherever it affects private rights and duties.

ADMINISTRATIVE LAWMAKING

No subtlety of analysis can classify every governmental action as uniquely legislative, administrative, or judicial. Administrators and judges invariably supplement legislation in applying statutes to particular cases. Adjudication is an element of all administration which touches private interests. The categories overlap in their very nature. Nor does the federal Constitution explicitly enact the separation of powers as a cardinal structural principle. Yet the architecture of its first three articles is clearly based upon the triangular pattern, and the Court has viewed the maintenance of intragovernmental equilibrium as one of its duties in the course of constitutional interpretation.

Support given by the words of the Constitution to the separation of powers is supplemented by the legal maxim *delegata potestas non potest delegari.* Since Congress derives its powers through the Constitution from the people, it is argued, it may not transfer the responsibility of their exercise to administrators. Extreme application of this principle, however, would in many instances make the execution of regulatory policy impossible. As the abortive experience with direct statutory fixing of railroad rates amply proved, general legislation cannot provide for the infinite variability of circumstances, and legislatures are not suited to the enactment of particular policies for each circumstance.

The courts have resolved the dilemma by permitting extensive delegation of legislative authority, sometimes thinly disguised under the term "quasi-legislative," subject to the requirement that the legislature lay down general standards to guide the exercise of administrative discretion. Approved standards have, in fact, been far from definite. Judicial sanction has been given to "reasonable rates," "due care," "adequate service," and "unfair discrimination."

Nonetheless, the principle of the separation of powers was em-

ployed to invalidate two elements of the New Deal recovery program. A section of the National Industrial Recovery Act, permitting the President at his discretion to forbid interstate transportation of "hot oil," was disapproved by a divided Court in 1935.[42] In the following year a unanimous Court struck down the remainder of the Act on similar grounds.[43] To give the force of law to NRA codes of fair competition, which might include almost any provision approved by the President as conducive to industrial recovery, was described by Justice Cardozo as "delegation running riot." Subsequent decisions indicate that the Court will be generous in permitting administrative lawmaking, provided that the Congressional objective is stated in reasonably specific terms.[44] Its readiness to do so depends, in part, upon its confidence in the methods of administration, which is conditioned, in turn, by adherence to the procedural requirements of due process.

PROCEDURAL DUE PROCESS AND JUDICIAL REVIEW OF ADMINISTRATION

The long-established meaning of "due process of law" lies in the realm of criminal procedure. Its application to civil administration is a development of more recent growth. Over the last half century, the courts have evolved in the name of this clause an elaborate set of rules governing the operation of administrative agencies in carrying out policies substantially affecting private rights and duties. Taken together, they constitute an important sector of what is now called administrative law. They are implemented by the requirement of judicial review.

Delicate and complex issues are at stake in the making of administrative law. They arise out of conflicts between the needs of effective enforcement of public policies on the one hand and avoidance of arbitrary denial of private rights on the other. While we adhere to the traditions of "a government of laws rather than one of men," government is perforce performed by men, whether they be judges, legislators, or administrators. The shift of a large share

[42] *Panama Refining Co.* v. *Ryan*, 293 U.S. 388 (1935).

[43] *Schechter* v. *United States*, 295 U.S. 495 (1935).

[44] See especially *Currin* v. *Wallace*, 306 U.S. 1 (1939); *Mulford* v. *Smith*, 307 U.S. 38 (1939); and *U.S.* v. *Rock Royal Co-operative*, 307 U.S. 533 (1939). Particularly noteworthy is the approval of delegated authority in certain areas of agricultural regulation where the effectuation of regulatory policies is made dependent upon approval by affected interests.

of economic policy making to the latter class is a consequence of underlying necessities of public policy.

In general terms, the requirements imposed by due process upon internal administrative procedure are simple. The agency must give a fair hearing to all affected interests, preceded by adequate notice. Its decisions must be made on the basis of substantial evidence, and it must demonstrate its conformity with this requirement by providing explicit findings. Affected parties must be allowed the right of appeal to the courts to test the validity of administrative action. Substantial flexibility is permitted, on the other hand, in the rules of evidence. Due leeway is given to administrators in view of their expert knowledge. They are presumed to be able to discriminate between the relevant and the irrelevant, and the harsh common-law restrictions on hearsay evidence are not applied to their proceedings.

In applying these principles, the attitudes of reviewing judges have sometimes threatened to convert the requirement of a fair hearing into a rigid procedural framework akin to that imposed upon the lower courts. The issue was brought to the fore in *Morgan* v. *United States*,[45] decided in 1938. The Supreme Court there invalidated an order of the Secretary of Agriculture under the Packers and Stockyards Act, on the ground that the respondents had not received a trial examiner's intermediate report as a basis for argument before the final decision, and had, therefore, not been afforded the "full hearing" required by the statute. For a time it was feared that this decision might cast into a single distorting mold the internal procedure of every regulatory agency, regardless of the particular administrative problems faced in its activities. A few months later, however, a unanimous Court declared that "the Fifth Amendment guarantees no particular form of procedure; it protects substantial rights."[46] The implications of the *Morgan* case for future administration remain uncertain.

Judicial review is also imposed to assure conformity of administrative actions with the statutes under which they are undertaken. Such protection against *ultra vires* action by administrators is an elementary essential of the "rule of law." In addition, decisions of

[45] 304 U.S. 1 (1938). A previous decision concerning another procedural aspect of the same case is reported at 298 U.S. 468 (1936).

[46] *National Labor Relations Board* v. *Mackay Radio and Telegraph Co.*, 304 U.S. 333 (1938).

administrators on the interpretation of their statutes are subject to judicial correction. Administrative findings of fact, on the other hand, must merely be supported by "substantial evidence." Court review is, in principle, limited to ascertaining a reasonable foundation for the findings; it is not supposed to extend to the weight of the evidence. Fact finding, indeed, is the very heart of the administrative process. If judicial review is extended to this field, administrative hearings become simply preliminary trials and the vital administrative role is transferred to the courts.

In practice, the distinction between law and fact is often a difficult one. Courts have sometimes recognized a category of "questions of mixed law and fact." Moreover, over the vigorous dissents of its liberal wing, the Supreme Court has repeatedly held that fact findings essential either to the jurisdiction of the administrative agency or to the constitutionality of its action must be reviewed *de novo* by the courts.[47]

More recently, the Court has extended its general attitude of self-restraint into decisions on the administrative-judicial relationship. The underlying causations which produced the administrative process are now receiving explicit consideration. The trend is strikingly exemplified by a recent unanimous opinion overruling a lower court's reversal of the Federal Communications Commission. Justice Frankfurter spoke for the Court in the following terms:

> Courts, like other organisms, represent an interplay of form and function. The history of Anglo-American courts and the more or less narrowly defined range of their staple business have determined the basic characteristics of trial procedure, the rules of evidence, and the general principles of appellate review. Modern administrative tribunals are the outgrowth of conditions far different from those. To a large degree they have been a response to the felt need of governmental supervision over economic enterprise—a supervision which could effectively be exercised neither directly through self-executing legislation nor by the judicial process. That this movement was natural and its extension inevitable, was a quarter century ago the opinion of eminent spokesmen of the law. Perhaps the most striking characteristic of this movement has been the investiture of administrative agencies with power far exceeding and different from the conventional judicial modes for adjusting conflicting claims—modes whereby interested litigants define the scope of the inquiry and determine the data on which the judicial judgment is ultimately based. Administrative agencies have

[47] Cf. *Crowell* v. *Benson*, 285 U.S. 22 (1932); *St. Joseph Stockyards Co.* v. *United States*, 298 U.S. 38 (1936).

power themselves to initiate inquiry, or, when their authority is invoked, to control the range of investigation in ascertaining what is to satisfy the requirements of the public interest in relation to the needs of vast regions and sometimes the whole nation in the enjoyment of facilities for transportation, communication and other essential public services. These differences in origin and function preclude wholesale transplantation of the rules of procedure, trial, and review which have evolved from the history and experience of courts.[48]

With expansion of regulatory activity under the New Deal, there arose a reaction against excessive administrative discretion. It resulted in part from government's entry into hitherto unregulated areas, in part from objection to the policies themselves. A powerful movement for restricting administrative lawmaking was set on foot, under the leadership of the American Bar Association. Out of an investigation by its special administrative law committee over several years, there evolved a measure to correct the alleged evils. Commonly known as the Walter-Logan Bill, it was introduced into Congress in 1939 and passed both Houses in the following year. In its final form, it contained three major requirements: (1) Administrative rules implementing regulatory statutes would be prepared only after formal public hearings. They would be subject to immediate judicial review in the form of declaratory judgments by the Court of Appeals of the District of Columbia, upon petition by any person "substantially interested in the effects" of the rules. (2) Regulatory agencies other than independent commissions would establish three-man boards within their organizations for formal quasi-judicial action at the demand of any person "aggrieved by a decision of any officer or employee" of the agencies. (3) Judicial review would be expanded and systematized for all administrative orders.

That the provisions were considered potentially serious impediments to effective administration is indicated by the exemption during the bill's passage of a long list of agencies toward which Congressional sentiment at the time was favorably inclined. Such exemptions applied to the Interstate Commerce Commission, the Federal Trade Commission, the Federal Reserve Board, federal lending agencies, and the administration of laws dealing with taxes,

[48] *Federal Communications Commission* v. *Pottsville Broadcasting Co.*, 309 U.S. 134 (1940).

patents, longshoremen and harbor workers, and agricultural marketing.

In December, 1940, the Walter-Logan Bill was vetoed by the President. While affirming his approval of the objective of improved administrative procedure, he expressed his conviction "that in reality the effect of this bill would be to reverse and, to a large extent, cancel one of the most significant and useful trends of the twentieth century in legal administration." It would, in his opinion, "turn the clock backward and place the entire functioning of the Government at the mercy of never-ending lawsuits and subject all administrative acts and processes to the control of the judiciary." The veto was sustained by the House of Representatives.

Meanwhile, the renewed attentiveness of the Supreme Court to matters of administrative procedure, together with pressure for legislation in this field, led to thoroughgoing re-examination of the problem by the administration on its own initiative. The internal organization and procedure of the Agriculture Department, the Labor Board, and other agencies were revised in an effort to conform with the requirements of the *Morgan* decision. A committee of distinguished experts in administrative law was appointed by the Attorney General early in 1939 to review existing procedures and recommend desirable administrative and legislative alterations. The committee began its work with a detailed critical analysis of the operations of thirty-three federal agencies, the results of which were summarized in a series of published staff monographs.

The final report of the committee was made public in January, 1941. On the basis of the staff investigations, proposals for reform were submitted with regard to each agency. In addition, seven of the eleven members agreed upon a series of general proposals applicable to the entire range of administrative procedure. Their major recommendations fall under seven heads. (1) Agency chiefs would be relieved of the burden of routine administration in order to devote their time wholly to important issues of policy. (2) Agency policies and procedures would be systematically made public, and the agencies would be authorized to issue binding declaratory judgments, subject to judicial review. (3) Solution of controversial issues by informal voluntary agreement would be promoted to the utmost possible extent. (4) An Office of Federal Administrative Procedure would be established, composed of a full-

time Director appointed for a seven-year term, together with a justice of the District of Columbia Court of Appeals and the Director of the recently created Administrative Office of the United States Courts. The new office would make continuing studies with a view to simplification and improvement of administrative procedure. (5) Where agency heads cannot themselves hear all cases, "hearing commissioners" would perform a portion of this function in place of the traditional trial examiners. They would be appointed for seven-year terms by the Office of Federal Administrative Procedure on the nomination of the agency to which they would be attached. The hearing commissioners would be charged with the sole function of initial hearing and decision in agency cases, and their decisions would be final unless appealed to the agency heads within a specified time. (6) No addition would be made to pre-existing requirements for judicial review. (7) Administrative rule making would be somewhat formalized and conferences with affected interests and public hearings encouraged, but not with the rigid uniformity proposed by the Walter-Logan Bill. Judicial review of such rules would be permitted only in connection with concrete cases.

A minority of three recommended a wider separation of the quasi-judicial function from other administrative activities, a broadened scope for judicial review, and a uniform statutory "code of standards for fair administrative procedure." A fourth member of the minority agreed with these views, but desired to carry the separation of functions and the enlargement of judicial review even further. With regard to the minority proposals, the majority expressed its conviction "that much of the code was unrelated to facts of more than isolated incidence and that many of its sections were inapplicable as a practical matter to many agencies."

The rapid growth of administrative regulation has undoubtedly entailed a number of procedural methods inadequately protecting affected rights. Reform along the lines suggested by the Attorney General's committee appears to promise a *via media* affording due consideration to such rights without obstructing the effective execution of public policy.

4. The Future of Constitutional Limitations

The years between 1937 and 1941 witnessed a drastic revision in constitutional limitations on government's economic activities. A half century of restrictive doctrine was virtually swept away. The central

feature of this change was a revival of judicial self-restraint, unprecedented since the days of Chief Justice Waite and perhaps more far reaching than at any time since Marshall ascended the bench. During this period, the Court refused any longer to read into the Constitution the prescription of a particular relationship between government and economic enterprise. It adhered firmly to constitutional protections for democratic organization, as its civil liberties decisions indicated, but rejected with equal firmness the identification of democracy with the tenets of laissez faire. Responsibility for policy making was thus replaced squarely on the shoulders of elected officials, legislative and executive. Constitutional issues were relegated for the time being to a minor role.

The focus of constitutional limitations has now shifted to administration. Less dramatic than the censorship of legislation, the influence of the judicial function in this sphere is no less significant in its impact on economic policy. It is a cardinal factor in determining the effectiveness of the administrative processes lying at the heart of the modern service state. Maintaining intact its historic role of protecting the individual from the abuse of administrative discretion, the judiciary must at the same time give sufficient scope to administrators to advance adequately the equally real interests with which they are entrusted. The Supreme Court has recently dedicated itself to co-operation between judges and administrators based on performance by each of the functions to which they are best suited. Implementation of this promise remains for the future. In the realm of public economic policy, it constitutes the major new frontier of constitutional decision.

Part II

GOVERNMENT AS PROMOTER OF PARTICULAR INTERESTS

Chapter Four. PROMOTION OF BUSINESS ENTERPRISE

1. The Concept of Promotion

Promotional activity as treated here involves the use of government to encourage, strengthen, protect, or advance the interests of particular groups, industries, or sectors of the economy on the assumption—not always justifiable—that such positive assistance will contribute to the general welfare. Business promotionalism involves the use of government to promote the interests of business enterprise. In a larger sense, the protection of property, the enforcement of contracts, the law of corporations, the rules for bankruptcy, and the power to grant patents may all be viewed as species of business promotionalism in so far as they aid business. But these more general rules which establish the framework for business enterprise will not be discussed here. Instead, attention will be focused on the more affirmative assistance rendered through tariffs, subsidies, services, and other forms of direct aid to particular interests.

Promotion may be used as a governmental policy for a variety of reasons. At its lowest level, it may simply be designed to satisfy the selfish aspirations of a particular group by a bald raid on the public treasury which involves no conceivable public benefits. Usually, however, those engaged in promotional activity offer a rationale which is intended to demonstrate that when government throws its weight behind a given group it is making a contribution to the common welfare. Sometimes the reasons adduced may be primarily of a military or strategic nature. Thus, George Washington justified the tariff in his first annual address to Congress: "The safety and interests of the

people require that they should promote such manufactures as tend to render them independent of others for essential, particularly military supplies." Sometimes the stress is on economic benefits which will be diffused as a result of the extension of aid to a particular interest. Thus, tariffs on manufactured products have been defended on the theory that they aid laborers and farmers as well as manufacturers; bounties to shipowners on the ground that they foster foreign markets for American products; subsidies to railroads on the assumption that they bring economic advantages to the regions through which they pass.

What is perhaps the classic statement of the case for business promotionalism was made by Alexander Hamilton during Washington's first term in a series of able reports dealing with such subjects as the public credit, the chartering of a national bank, the institution of a system of currency, and the encouragement of manufacturers. Hamilton was interested in the establishment of a strong central government drawing its primary support from banking, commercial, and manufacturing interests and dedicating its energies to promoting the growth of business enterprise in the United States. The Hamiltonian program, which was in the main enacted, was calculated to realize these objectives. It provided for the assumption of the Continental and state debts by the federal government, the establishment of a chartered national bank, a mint, an American system of coinage, the passage of tariff legislation, and a land policy designed to bring in revenue to redeem the public debt.

Particularly noteworthy as an exposition of the Hamiltonian system was the famous *Report on the Subject of Manufactures* (1791). In this report Hamilton sought to demonstrate that the development of manufacturing would redound to the benefit of the whole nation, including agriculture. Manufacturing, he argued, would increase national wealth, provide employment, stimulate emigration from foreign countries, multiply the objects of enterprise, encourage the natural aptitude of the American people for mechanical arts, and foster the genius for invention. It would be of direct benefit to the agricultural classes by substituting for an uncertain and varying foreign market a reliable and steady domestic market; workers in industry would increase the home demand for agricultural produce. To encourage manufacturing, Hamilton favored a system of premiums and bounties for new enterprises, but this scheme was passed over because of the large expenditures involved. Instead, only a part

of Hamilton's proposals—those for mild customs duties—was adopted by the early Congresses.

The Hamiltonian program identified the prosperity of the nation with the prosperity of the business classes. The role of government was to dispense privileges to business; with business in a favored position, the resulting economic benefits would percolate to other groups and be diffused through the whole economy. This point of view, which was to become an important strand in the American political tradition, nevertheless rested on a narrow political base. It held out direct and tangible rewards to businessmen; the benefits which it promised other groups were frequently remote and indirect. A more inclusive formula had to be evolved if the foundations of business promotionalism were to be secure.

Henry Clay's "American System," which first came into prominence in the first quarter of the nineteenth century, was an effort to satisfy this need. It held out the promise of a sound banking system and protective tariffs for the businessmen and industrialists of the East; at the same time it offered a program of federally sponsored internal improvements to attract farmers and businessmen in the West. By widening the prospective beneficiaries of government largess, it sought to consolidate business and agrarian strength. Though the strategy was statesmanlike, the execution proved difficult. The Whig Party, which espoused the "American System," enjoyed only temporary and intermittent success. The fulfillment of the "American System" had to await the emergence of the Republican Party, which succeeded in cementing a more durable alliance between the business and industrial interests of the East and agrarian elements in the West.

The early opposition to business promotionalism found its most effective leaders in Jefferson and Jackson. Jefferson's preference for an agricultural society is well known.[1] Not so well known is his

[1] His remarks in his *Notes on Virginia* have been frequently quoted. "While we have land to labor, let us never wish to see our citizens occupied at a workshop or twirling a distaff. . . . Let our workshops remain in Europe. It is better to carry provisions and materials to workmen there than to bring them to the provisions and materials, and with them their manners and principles. . . . The mobs of great cities add just so much to the support of pure government as sores do to the strength of the human body." Later, in a letter to Madison, he wrote: "I think our governments will remain virtuous for many centuries, as long as they are chiefly agricultural; and this they will be as long as there shall be vacant lands in any part of America. When they get piled up upon one another in large cities, as in Europe, they will become

partial conversion to a protective tariff on manufactures after the interruptions of commerce during the Napoleonic Wars and the War of 1812 had demonstrated the hazards of reliance on foreign supplies. In a letter to Benjamin Austin, written in 1816, he declared:

We must now place the manufacturer by the side of the agriculturist. Experience has taught me that manufactures are now as necessary to our independence as to our comfort; and if those who quote me as of a different opinion will keep pace with me in purchasing nothing foreign when an equivalent of domestic fabric can be obtained, without regard to difference in price, it will not be our fault if we do not soon have a supply at home equal to our demands, and wrest that weapon of distress from the hand which has wielded it.[2]

Jackson took a similar view, at least as regards "those leading and important articles so essential to War." [3]

While both Jefferson and Jackson were thus prepared to make concessions to business promotionalism, they were not prepared to tolerate the subordination of agriculture to industry. It is in this framework that Jefferson's struggle with Hamilton and Jackson's fight against Biddle and the Bank of the United States assume significance. Jefferson and Jackson, and their followers, were less concerned with utilizing government as a positive instrument to advance agrarian objectives than they were with preventing its exclusive utilization by business and banking groups to promote commercial interests. The Jeffersonian slogan, "Equal rights for all—special privileges for none," epitomized this attitude. A plank in the Democratic Party platform of 1840 gave it terse expression: "Justice and sound policy forbid the federal government to foster one branch of industry to the detriment of another, or to cherish the interests of one portion to the injury of another portion of our common country." [4] During the pre-Civil War period, when the Democratic Party and its agrarian followers were in the ascendancy, these views served to impose restraints on programs for business promotionalism.

The changed setting after the Civil War shifted the balance of political forces. The Republican Party became the dominant party

corrupt as in Europe." Quoted in H. J. Ford, *The Rise and Growth of American Politics* (1914), p. 104.

[2] Quoted in Charles A. Beard, *The Idea of National Interest* (1934), p. 317.

[3] *Ibid.*

[4] *Ibid.*, p. 320.

and carried on the Hamiltonian and Whig tradition. While it depended upon and catered to Western agrarian support, its leadership was closely associated with the rising industrial forces, and its policies were primarily shaped by the proclaimed needs of business enterprise.

With the triumph of business promotionalism, dissatisfaction developed among farmer, labor, and other groups who failed to share in its bounty. The reaction took two somewhat different directions. On the one hand, it involved a demand that business be "regulated," that is, that checks and restraints be imposed to stamp out alleged abuses. On the other hand, it expressed itself in a plea that disadvantaged groups be given privileges corresponding to those enjoyed by more favored groups. If government is to dispense privileges, the argument went, it cannot limit the beneficiaries. It must universalize privilege. The logic of protection for one group led to the call for "protection all around." Thus, business promotionalism inspired movements for agrarian and labor promotionalism and a competitive race for privileges was set in motion.

2. The Tariff: A Case Study in the Promotion of Business Enterprise

Historically, the tariff has represented perhaps the most effective weapon in the arsenal of business promotionalism. Behind the ramparts of rising tariff walls, industry after industry has been guaranteed a domestic market free from foreign competition, and powerful vested interests have been established and consolidated in the defense of the existing protective tariff system. Although tariffs are, in effect, taxes which raise prices to domestic consumers in areas of the economy where domestic competition does not operate to restrain such tendencies, consumer consciousness of the impact of tariffs is obscured by the fact that their effect is swallowed up in the total price of the protected commodity. At the same time, a persuasive symbolism of national interest has been built up around the institution of the protective tariff. The importance of protected industries for national defense, their contribution to national prosperity, the market which they provide for agricultural producers, protection of the standard of living of American workers—these and analogous

arguments are designed to provide a strong compulsion to treat the protective tariff not as an expression of private interest, but as an embodiment of the public interest.

In analyzing the history of American tariff policy at least five distinct periods can be noted:

(1) 1789–1815, when protectionist policy was taking shape, but was not yet really applied in full force.

(2) 1816–32, when there was a considerable rise in tariffs and the system of protection had its first great triumph.

(3) 1833–60, when, with the exception of a short interruption between 1842 and 1846, protectionist policy was under severe attack and duties were lowered.

(4) 1861–1933, when, with minor interruptions under Cleveland and Wilson, the trend of tariff rates was sharply upward.

(5) 1934— since when, under the influence of the Trade Agreements program, the trend of tariff duties has been predominantly downward.

Between 1789 and 1815, the outlines of American protectionist policy began to emerge. Although the Tariff Act of 1789 had only a mildly protective purpose, Hamilton's *Report on Manufactures* gave the protectionist movement impetus, and subsequent tariff acts provided for cumulative increases in rates. The stimulus to manufacturing was at first slight. As a result of the European wars, a large part of the carrying trade fell into American hands; international trade was extraordinarily profitable; and capital flowed into commerce rather than manufacturing. After 1807, embargoes and the war with England dealt a severe blow to foreign commerce. The scarcity and high price of imports worked to the advantage of domestic manufactures. Capital which had previously been invested in commercial pursuits was now placed at the disposal of manufacturers. Manufacturing interests began to flourish, and also to petition for higher duties.

The real victory of the so-called American System of protection did not come until 1816. American industries which had begun to develop in the previous period were apparently threatened with bankruptcy as a result of the inundation of American markets with British goods after the end of the Napoleonic Wars and the War of 1812. The clamor for protection was spurred on by resentment against England. Patriotism was invoked; it was necessary to emancipate the country from English influences. The vested interest argument was

transformed into national interest; strategic military considerations dictated that the country not be deprived of already established industries which were adapted to its use and necessary to its survival. Jeffersonian statesmen joined the cry for protection. From the Act of 1816 through the Act of 1828, each tariff revision registered an upward movement of rates.

By 1824, however, advocates of high tariffs were encountering increasingly strong opposition from agrarian spokesmen. Farmers who bought manufactured goods in protected markets and sold their crops in the world market found themselves disadvantaged by the direction which tariff policy was taking. Southern cotton planters ceased to regard protection as a phase of national interest and assailed it as a vested sectional interest. The tariff of 1828 became the "tariff of abominations" in the eyes of its opponents. Though the Act of 1832 reduced duties to the approximate level of the Act of 1824, dissatisfaction continued. "Nullification" sentiment ran strong in the South, and in South Carolina almost flared into open revolt. Only Jackson's firm antinullification stand and the further reduction of duties provided by Clay's Compromise Act of 1833 finally quieted the discontent.

From 1833 until the Civil War, with the exception of a short interlude between 1842 and 1846, tariff duties declined. The Democratic Party dominated the politics of the period, and the Party, in turn, reflected the tariff views of its predominantly agrarian constituency. The Act of 1842, which raised average rates to the level of 1832, was enacted by the Whigs and repealed in 1846 as soon as the Democrats were returned to power. While industrialists urged that tariff rates be increased and pointed their appeal in labor and humanitarian terms by stressing the connection between high tariffs and high wages, they were unable to make headway in the face of an inhospitable political environment.

With the year 1861, the direction of American tariff policy was sharply reversed. During the Civil War, the rise in tariff rates was chiefly inspired by fiscal needs. At the close of the war, however, the high war rates were retained. Protectionists seized the opportunity to consolidate their position, to oppose reductions, and to press for further increases. Reconstruction offered a golden opportunity. The temporary disfranchisement of the South assured Republican ascendancy, and the Republican Party proved hospitable to high tariff advocates. The tariff lobby became an indigenous part of the American scene.

Wool, copper, salt, iron, and a host of other commodities all set up their shops in Washington, and Congressmen (like "Pig-iron" Kelley) began to be described by the commodities for which they spoke.

It is interesting to note how the politics of gaining acceptance for high tariffs was perfected. Industrialists rarely opposed each other's appeal for protection, and a solid phalanx of industrial support was thus assured. The farmer was placated with the Homestead Act and free land. When that appeal was exhausted, the system of protection was extended to agricultural commodities. In some instances, as in the case of wool, sugar, and dairy products, real benefits were conferred, and the loyalty of particular agrarian interests to the protective tariff system was thus cemented. In other instances, as in the case of wheat, rye, barley, and other export crops, the benefits were dubious, but the inclusion of these agricultural commodities in the protected list afforded "psychological" satisfaction and thus helped to disorganize potential agrarian opposition. As urban laborers multiplied in numbers, the appeal to them was directed in terms of protecting the interest of labor in high wages. The tariff was identified with the "full dinner pail." Reduce the tariff and unemployment would spread through the land; wages would fall to the "pauper" level of Europe and Asia. Arguments such as these were remarkably effective in mobilizing widespread support for a high tariff policy. Meanwhile, infant industries grew into giants and competition began to give way to organization and monopoly.

To be sure, efforts were made to reduce tariffs in the period between the Civil War and the New Deal, but these efforts were, for the most part, ineffective. A slight reduction was made in 1872, only to be restored three years later. The return of the Democratic Party to power in 1892 produced the Tariff Act of 1894, which provided, however, for some increases in rates as well as reductions. President Cleveland refused to sign the Act, and its chief significance was to demonstrate the extent to which the Democratic Party itself had become honeycombed with local interests of a protectionist nature. The insurgent movement which led to the split in the Republican Party in 1912 had its origin, in part, in a protest against the high rates of the Payne-Aldrich tariff of 1909. Meanwhile, dissatisfaction with legislative tariff making was mounting. In 1909, President Taft appointed a Tariff Board to aid him in the exercise of his discretionary powers under the Tariff Act of that year, but the Board came to an untimely end

in 1912 as a result of the failure of Congress to make appropriations for its continuance.

With the coming of the Democrats into power in 1913, a downward revision of the traditional high tariff policy seemed probable. Party leaders promised "a competitive tariff," a vague formula which seemed to mean that tariff rates would be fixed at a level which would not exclude foreign goods, but would at the same time enable American producers to compete with foreign producers on equal terms. While the formula was evasive, the Underwood Act of 1913, which sought to implement it, marked the first important tariff reduction in over fifty years. Meanwhile, the difficulties of deciding what rates made a tariff truly "competitive" brought home the necessity of having some kind of fact-finding body to furnish accurate information to guide legislative judgment. As a result, the Tariff Commission, a bipartisan body, was established in 1916. It was not authorized to recommend policies or to suggest rates. It was simply an information-gathering body. Under war conditions it had little influence. In fact, the outbreak of the first World War largely nullified efforts at tariff reduction. The wartime disturbances in foreign trade, by cutting off imports from Germany and Austria, and by restricting imports from other industrial countries, had the effect of giving greatly increased protection to many American industries.

After the Armistice, nationalistic sentiments and business interests combined to oppose any downward revision of tariffs and, indeed, pressed for new increases. American manufacture of certain products such as dyestuffs had been so greatly expanded during the war as to establish practically new industries. These "war babies" emphasized their infant status, and argued that without protection they would be unable to withstand peacetime German competition. Other industries made much of the danger of exchange dumping from Europe, where currencies showed great instability. Furthermore, American farmers suffered from a severe collapse of prices in 1920–21, and demanded protection against imports of Canadian, Argentine, and other foodstuffs and raw materials.

The Republican return to power in 1921 was the signal for tariff revision. Insurgent elements in the Republican Party were weak. Farmers were reconciled to the continuance and even to increases of high duties on manufactured goods by the promise of extension of protection to agriculture. The Emergency Tariff Act of 1921 and the Fordney-McCumber Act of 1922 inaugurated a new era of pro-

tectionism. As a result, the tariff level was raised to a point higher than had been attained in any prewar act.

A new feature, first found in the Act of 1922, was the so-called flexible provision. Its object was to transfer part of the task of tariff revision from Congress to the Executive. The President was given power to raise or lower duties by as much as 50 per cent of the statutory rate. This power was to be exercised only if investigation by the Tariff Commission showed that changes in the statutory rate were necessary to equalize differences between the foreign costs of production of the article in question and its domestic costs. The new machinery proved cumbersome and impractical. "Equalizing the costs of production" was a formula which offered no clear guide to action. Costs vary from those of the "marginal" producer to the most efficient. The Act did not make clear which were to be considered, either at home or abroad. In the absence of such guidance, the accurate compilation of cost data and the comparisons of costs were necessarily attended with great difficulty.

Some tariff reformers had hoped that the new Presidential power would be used extensively to lower the 1922 rates. This hope proved delusive. In the following eight years, the duties were changed on only thirty-nine commodities out of twenty-eight hundred listed in the tariff schedules, and only six of these changes were downward. Had a widespread public demand for lower tariffs manifested itself after 1922, probably a greater use would have been made of this administrative device. But during the twenties, tariff revision was not a serious political issue. Exports boomed, and were largely financed by loans abroad. There was relatively little realization that the shift of the United States from debtor to creditor status required a modification of tariff policy if debts were to be serviced and repaid. Businessmen and the general public were content to let well enough alone. Presidents Coolidge and Hoover showed no inclination to tamper with statutory rates. In fact, their influence was exerted to maintain them.

The sole effect of the business depression which began with the stock market crash of 1929 was to stiffen the American protective system. In 1930, the Hawley-Smoot Tariff Act raised American import duties considerably above the already high levels of the Act of 1922. Though more than a thousand American economists joined in a plea to President Hoover to veto the bill, he approved it somewhat reluctantly and the bill became law. The results were disastrous.

The disparity between agricultural and industrial prices was widened. The additional barriers raised against the entrance of foreign goods into the United States made debt payments difficult and was a contributing factor in inaugurating a series of debt repudiations. At the same time, the Act provoked retaliatory measures abroad which contributed to the decline of world trade and the ensuing world depression. During 1931 and 1932, a wave of tariff increases swept across the world, reinforced the tendency toward autarchy, and sharpened political and economic bitterness between nations. American foreign trade suffered sharp shrinkage. Exports declined from $5,200,000,000 in 1929 to $1,647,000,000 in 1933. Imports fell off from $4,399,500,000 in 1929 to $1,450,000,000 in 1933. During the final year of Hoover's administration, further efforts were made to restrict imports by imposing import excise taxes on lumber, coal, copper, crude petroleum and petroleum products.[5] The Roosevelt administration in the beginning continued this policy by extending import excise taxes to a group of agricultural products.

With the inception of the New Deal, the Democratic Party showed itself divided on the subject of tariff policy. One wing, led by Secretary of State Hull, whose predilections favored free trade, wanted to move in the direction of sharp reductions in the tariff. Another wing, which was particularly strong in the councils of the NRA and AAA, was committed to high tariffs in order to protect the New Deal experiments in price raising from disturbances abroad.[6] In these circumstances it was difficult to be certain where Congressional tariff revision, once initiated, would lead.

The way out of this dilemma was found in the Reciprocal Tariff Act of 1934, which was enacted as an amendment to the Tariff Act of 1930. The Act registered a victory for the forces favoring tariff reduction. The President was authorized to negotiate trade agreements with foreign countries. In these agreements reductions of import duties, not exceeding 50 per cent, could be made in exchange for corresponding concessions on American exports.[7] Articles on the

[5] Excise taxes on imports operate in the same manner as customs duties to restrict imports.

[6] Section 3(e) of the National Industrial Recovery Act gave the President power to exclude, limit, and control imports when it appeared after investigation by the Tariff Commission that the effect of such imports might be "to render ineffective or seriously to endanger the maintenance of any code. . . ."

[7] A system of interdepartmental committees was established to carry out executive responsibilities in connection with the Trade Agreements program. An Executive

free list could not be transferred to the dutiable list, and vice versa. The Act also provided that tariff reductions incorporated in trade agreements be made generally applicable to the goods of all countries, except those which discriminate against American commerce.

As a political technique for the achievement of tariff reductions, the Trade Agreements program had much to commend it. In contrast with legislative tariff making, where logrolling enables a multitude of local interests to unite in one omnibus measure, tariff bargaining by the Chief Executive involves piecemeal revision of rates and thus makes possible the isolation of protected interests. At the same time, since it provides for expansion of exports, it offers inducements to the exporting interests, which expect to benefit by the reciprocal agreements, to rally to the support of the trade agreements and to counteract the opposition of those who claim to be injured by the concessions which the agreement contains.

Since 1934 over twenty trade agreements have been negotiated. While the trend of tariff rates has been downward, it remains true that the agreements so far concluded have only slightly modified the rigorous protectionism of the Hawley-Smoot Tariff. Reductions in rates have been confined, for the most part, either to specialties not directly competitive with any American product, or to commodities of which the domestic supply is deficient, or to commodities in which American production so dominates the home market that increased imports can have relatively little effect on price. In the great controversial tariff areas, such as iron and steel, duties have been little affected. After six years of trade agreements, American producers still operate, by and large, in a protected domestic market, and the program has done relatively little to disturb them in their shelter.

Before the outbreak of war in 1939, the Trade Agreements program was chiefly significant because it revealed at least *some* willingness on the part of the United States to give an impetus to the reduction of world trade barriers by lowering its own tariff duties. Despite intense opposition from some industrial and agricultural interests, the movement received warm support from business groups

Committee on Commercial Policy was appointed to consider broad questions of commercial policy. The immediate task of formulating and negotiating agreements was vested in an Interdepartmental Committee on Foreign Trade Agreements, which in turn set up country committees, commodity committees, and other special subcommittees. In order to provide a channel through which interested parties could express their views on proposed agreements, a Committee for Reciprocity Information was established to hold hearings and receive testimony.

seeking to expand exports and from growers of export crops who sought outlets for their surplus produce. The latter groups remain interested in an expansion of international trade and may be prepared to press for an extension of the Trade Agreements program if the outcome of the war provides a hospitable environment. While war rages, the channels of trade are necessarily distorted. The future of trade agreements and of the tariff as an instrument of business promotionalism is inextricably bound up with the pattern of world organization which emerges at the end of the present conflict.

3. The Merchant Marine and American Shipping Policy

The history of government aid to promote ship ownership and construction by American business interests furnishes another interesting case study in business promotionalism. Solicitude for American shipping interests was manifested at the very first session of Congress in 1789. Under legislation enacted in that year, only ships built in the United States and belonging to American citizens could register under the American flag; goods imported in American vessels were granted a 10 per cent reduction in customs duties; and a discriminatory tonnage tax was imposed in favor of American shipping. Since the tonnage tax on foreign vessels was payable on every entrance into an American port, its practical effect was to reserve the coastal trade for American-owned vessels. Under the stimulus of these measures, American shipyards thrived and the merchant marine underwent a period of rapid expansion. This expansion was aided by the outbreak of war in Europe, which created new opportunities for American shipping as the merchant fleets of the belligerents suffered serious losses. Between 1789 and 1810, American tonnage engaged in foreign trade increased from 123,893 tons to 981,000 tons.[8]

The War of 1812 dealt American shipping a heavy blow, but its effects were temporary. After the war the merchant marine resumed its growth, though at a slower pace than in the prewar years. By 1855, American tonnage in foreign trade reached a total of 2,348,000 tons. Until the gradual replacement of wooden ships by their iron rivals in the late eighteen-fifties and eighteen-sixties, American shipyards and the merchant marine remained prosperous and were able to hold their own in competition with the rest of the world. American shipping policy, meanwhile, moved in a liberal direction. The Navi-

[8] Paul M. Zeis, *American Shipping Policy* (1938), pp. 4–6.

gation Act of 1817, to be sure, excluded foreign vessels from the American coastal trade. But the United States declared its willingness to repeal discriminating duties and taxes on vessels engaged in foreign trade in exchange for similar concessions by other countries, and a large number of reciprocity agreements were concluded.

The first use of direct subsidies in the United States came after the British government had provided a mail subsidy to aid Samuel Cunard in establishing a passenger steamship service to this country in 1840. In 1845, Congress authorized the Postmaster General to award mail subsidies, with preference to be given to steamships which might be converted into vessels of war. Between 1847 and 1858 a total of $14,400,000 was expended on mail subsidies to help establish various steamship lines to Bremen, Le Havre, Liverpool, Panama, Oregon, and Cuba. The first experience with subsidies was unsatisfactory. A number of the lines became involved in financial difficulties and pressed for increased aid. Subsidies appeared to many as an unnecessary drain on the public treasury. In 1858 the subsidies were discontinued.

After the Civil War, the American merchant marine entered upon a period of decline which continued down to the first World War. With the triumph of the iron ship, ship construction became considerably cheaper in Great Britain than in the United States. High tariffs on shipbuilding materials contributed to this disparity. As a result, shipowners pressed for what came to be called the "free ship" policy, the right to purchase ships abroad and fly them under the American flag. This policy was vigorously contested by shipbuilders, who suggested instead that the navigation laws requiring ships in American registry to be built in the United States be retained and that higher costs be met by government subsidy.

For a short period at the end of the Civil War (1865–74), mail subsidies were revived. Subsidies were granted to steamship companies carrying mail to Brazil, Hawaii, and the Far East. The trade promotion which was expected to follow the establishment of the line to Brazil failed to develop. The subsidies to the Pacific Mail Line produced one of the worst scandals of the Grant era. The investigation of the activities of the Pacific Mail lobby brought the whole subsidy process into disrepute, and in 1874 all existing subsidy contracts were terminated.

During the next two decades, while the foreign trade fleet shrank, the battle between the advocates of "free ships" and subsidies con-

tinued. A curious realignment of interests developed. Coastal shipowners, who now represented the largest part of the American merchant marine, were opposed to "free ships" because of fear that they would be permitted to enter and compete in the coastal trade. A number of ship operators in foreign trade joined forces with shipbuilders and manufacturers of steel and other shipbuilding materials in calling for subsidies. This policy was espoused by the Republican Party. A few shipowners in foreign trade remained adamant and continued to press for "free ships" with the support of Southern and Western agricultural interests in the Democratic Party, but they were unable to carry out their program.[9]

In 1891 Congress enacted the Ocean Mail Act, which provided for mail subsidies, but in amounts considerably less than the advocates of subsidies had hoped to obtain. The Act remained in force until 1928, during which time a total of $29,630,000 was expended. More than half of this amount went to the American Line which operated between New York and England. Few new lines were established and the Act had no appreciable effect in enlarging the American merchant marine. After the election of McKinley in 1896, the drive for larger subsidies increased in vigor. But despite powerful support from the dominant Republican leadership, new subsidies in the form of "direct" payments could not be obtained. Indirect aid, however, was made available. In 1898 and 1899 Congress expanded the coastal trade monopoly by reserving all trade between the United States, Hawaii, and Puerto Rico for American shipping.

The growth of Democratic and Progressive strength in Congress after 1909 shifted the emphasis of shipping legislation from promotion to regulation and control. The Panama Canal Act of 1912 introduced a limited free ship policy,[10] but the advantages held out were

[9] The "free ship" group won several minor victories. The tariff of 1890 permitted free importation of iron and steel plate for shipbuilding purposes, and the tariff of 1894 extended the free list to include all shipbuilding material. But ships so constructed were permitted to engage in the coastal trade only two months a year. This effectively discouraged purchase.

[10] The Act allowed foreign-built vessels not over five years old to be operated under American registry in the foreign, though not in the coastal, trade. Such vessels were to be eligible for mail contracts. All shipbuilding material was to be allowed entry duty free, and vessels constructed from such material were to be permitted to engage in the coastal trade without restriction. The policy with regard to shipbuilding material was later reversed by the Tariff Act of 1922, which required payment of regular duty rates on material for shipbuilding.

not sufficient to induce American shipowners operating under foreign registry to transfer to the American flag. The passage of the Seamen's Act in 1915 helped to ameliorate the conditions of sea employment. Efforts were made to control shipping combinations, and regulatory provisions outlawing discriminatory practices and giving the Shipping Board power to "disapprove, cancel, or modify" agreements entered into by common carriers were subsequently embodied in the Shipping Board Act of 1916.

Meanwhile, the outbreak of the first World War changed the whole character of the shipping problem. The United States was faced with a severe shortage of merchant shipping. American ship registry laws were liberalized to admit foreign-built ships owned by American citizens. In 1916 a Shipping Board was established with power to create an Emergency Fleet Corporation, which in turn was authorized to purchase, construct, and operate ships in foreign commerce. The operations of the Corporation were not to extend beyond a five-year period after the close of the war. The sum of $50,000,000 was provided in the initial appropriation, but after American entrance into the war the demand for tonnage increased so greatly that the appropriation was increased to approximately $3,000,000,000. The gigantic emergency shipbuilding program proved to be costly, wasteful, inefficient, and slow. Construction was undertaken through private contractors, many of them without any previous experience in building ships. Private profits were fabulous. Of a projected building program of 18,000,000 tons, less than one sixth was delivered before the Armistice. The larger part of this total consisted of vessels already under construction in American shipyards when the Fleet Corporation began its operations. Indeed, the shipbuilding program was just beginning to get well under way when the Armistice was signed, and more than one third of the entire fleet constructed for the Shipping Board was commenced after the war was over. Meanwhile, materials acquired in the course of the construction program were being disposed of at small fractions of their value.

At the close of the war the Republicans were once more in the ascendancy, and the stress of public policy was heavily on the promotion of private shipping interests. The Merchant Marine Act of 1920 contemplated private ownership and operation of the government wartime fleet, and the new Shipping Board, which was established by the Act, was instructed to sell the ships to private interests

as soon as possible. Failing sales, the Shipping Board was given power to charter ships to private companies or to operate them itself. The Act also set up a construction fund of $25,000,000 from which loans could be made on favorable terms to aid private companies to build new ships.

The policies of the Shipping Board evidenced a tender solicitude for private shipping interests. Between 1921 and 1928, the Board sold 1,164 ships representing about 5,500,000 tons, at a rate of $17 or $18 a ton, a small fraction of the original cost. Ships which had cost $516,000,000 were disposed of for approximately $41,500,000. Many cargo vessels were sold as scrap for about $8.00 a ton, although in numerous cases the vessels were still in good condition. A large part of the remaining government fleet was withdrawn from active operation in order not to compete with private enterprise. By August 31, 1925, there were only two hundred and twenty-eight cargo and fifteen passenger vessels of the government fleet still in operation; most of these were operated not by the government directly, but by managing agents under government contracts which guaranteed the operators against losses.

The Jones-White Mail Subsidy Act of 1928 provided further aids for the private shipping industry. The construction loan fund was increased to $250,000,000, and the terms of loans were made easier. Mail subsidies were liberalized and payments gradually increased from $9,000,000 for the fiscal year 1929 to $29,000,000 for the fiscal year 1934. With generous subsidies now available, the government-owned or operated lines which remained, became attractive to private shipping interests and the Shipping Board hastened to offer them for sale. In some instances, sales were made under conditions which laid the Shipping Board open to charges of gross favoritism toward powerful shipping interests. The operations of the subsidy program developed numerous abuses. Subsidies were diverted into high salaries, excessive dividends, and profits for affiliates of the parent shipping company, instead of going into maintenance or new construction. Between 1921 and 1935 the tonnage employed in foreign trade under the American flag shrank from 11,000,000 tons to 4,500,000 tons. Very little new construction was undertaken. By 1935 the American foreign trade fleet was rapidly reaching the point of total obsolescence.

The most recent phase in the development of American shipping policy was inaugurated by the passage of the Merchant Marine Act

of 1936.[11] The mail subsidy system was abandoned in favor of a system of direct subsidies. The newly established United States Maritime Commission was authorized to grant two types of subsidy to private shipping interests: one for construction and the other for operation. Both construction and operating subsidies were to be determined by the differential between foreign and domestic shipping costs, a measuring rod of very uncertain application. Additional operating subsidies could be paid to offset the effect of foreign subsidies. Safeguards were included in the Act to prevent a repetition of the abuses which had discredited the mail subsidy system. If subsidies proved ineffective in stimulating a rebirth of the American merchant marine, the Maritime Commission was empowered to construct ships on its own account, sell or charter them if possible, and operate them itself if necessary.

The Merchant Marine Act of 1936 thus committed the United States to a continuation of the policy of subsidizing private shipping interests. In its *Economic Survey of the American Merchant Marine,* the Maritime Commission estimated that construction and operating subsidies would aggregate from $25,000,000 to $30,000,000 a year.[12] From July 1, 1937, through October 31, 1939, operating subsidies totaled $15,000,000 and construction payments nearly $36,000,000. Between October 20, 1937, and July 31, 1940, contracts were let for the construction of one hundred and fifty-nine vessels, of which forty-two were completed and placed in operation and ninety-seven reached the keel-laying stage. Under the pressure of war conditions, the original construction program of five hundred ships in ten years has been greatly accelerated and vastly expanded plans for new construction have been prepared.

Whether the present subsidy program will be more successful than previous efforts in promoting a strong American merchant marine still remains to be demonstrated. Historically, subsidies to private shipping interests have been justified on the ground that a large foreign trade fleet gives employment to American citizens and capital, contributes to national defense, ensures against interruption of serv-

[11] In 1933 the discredited Shipping Board was abolished, and its functions transferred to the Shipping Board Bureau in the Department of Commerce. The Bureau, in turn, was replaced in 1936 by the Maritime Commission. Legislation was also enacted in 1935 and 1936 providing for improvements in safety requirements, inspection services, and working conditions of seamen.

[12] United States Maritime Commission, *Economic Survey of the American Merchant Marine* (1937), p. 84.

ice in time of war, and promotes foreign trade by improving the quality of service available to American businessmen by safeguarding them against discrimination. Whatever the validity of these arguments in favor of a large merchant marine may be, it still remains doubtful whether this objective can best be attained by a program of subsidies to private shipping interests. Experience with subsidies in the past is not encouraging. Subsidies too often have operated to enrich the receiver rather than to maintain or enlarge the fleet. It remains to be seen whether the pitfalls of the past can be avoided in the administration of the present program.

4. Public Aids to Transportation

Transportation represents another special area where government aid has been made freely available to promote business enterprise. Railroads, water carriers, motor carriers, and air carriers have all enjoyed public aid in greater or less degree and continue to vie with each other for favorable treatment. The character of the aid extended has varied with the particular mode of transportation.

PUBLIC AIDS TO RAILROADS

Railroads from the very beginning have been the beneficiaries of public favor. Before 1850, public aid to railroads was largely state and local aid. Congressional bills proposing land grants to railroads were regularly defeated, in part because of prevailing constitutional scruples, in part because of the local character of the aid sought. Indirect assistance, however, was made freely available. This took the form of adjustments in the import duty on railroad iron, mail service contracts, and grants of rights-of-way over public lands.

The great era of federal railway land grants opened in the second half of the nineteenth century. Beginning with the Illinois Central grant in 1850 and extending through 1871, hardly a session of Congress passed without some grant. The system reached a high point in the years 1862–66, when over 100,000,000 acres were turned over to the railroads. This was the period of the Pacific railway charters, when the rush to span the continent was in full swing, and a fever of speculative railroad building seized the nation. By 1870 opposition began to mount. In that year the House of Representatives adopted the following resolution:

> Resolved, That in the judgment of the House the policy of granting subsidies in public lands to railroad and other corporations ought to be discontinued; and that every consideration of public policy and equal justice to the whole people requires that the public lands of the United States should be held for the exclusive purpose of securing homesteads to actual settlers under the homestead and pre-emption laws, subject to reasonable appropriation of such lands for the purpose of education.[13]

The underlying sentiment here was unmistakable. Once the railroads were established and abuses revealed themselves, promotion began to give way to regulation, and a strong movement was launched for the forfeiture of land grants by railroads which had been unable to meet the required conditions. Meanwhile, the grand total of federal and state land grants received by the railroads amounted to approximately 183,000,000 acres.[14]

After 1871 public aid to railroads became of relatively minor importance until the depression of 1929 generated new pressure for assistance. This time promotional activity took on the character of salvage. The Reconstruction Finance Corporation, which was established in 1932, was authorized, among its other powers, to make loans to railroads to be used for refunding purposes, to meet interest, wages, and taxes, and to provide for minor additions to property. The Public Works Administration, which was created in 1933, also made loans to finance railroad maintenance and equipment.

Efforts to calculate the extent of public aid which has been given to railroads must necessarily be rough approximations. The following table presents the most accurate estimate available:

SUMMARY OF PUBLIC AIDS GIVEN TO RAILROADS[15]

Form of aid	*Amount of aid*
A. To secure construction of railroads:	
Drawbacks of duties on railway iron, and expense of Federal railroad surveys	$ 6,000,000
Federal and state land grants	429,000,000
Federal and state right-of-way grants	87,000,000
Lands donated for right-of-way and other carrier	

[13] Quoted in L. H. Haney, *Congressional History of Railways*, Vol. II (1910), p. 21.
[14] Federal Co-ordinator of Transportation, *Public Aids to Transportation* (1940), Vol. I, p. 13.
[15] *Ibid.*, p. 19.

purposes by local governments, individuals, associations, and private corporations, including apparent aids	232,000,000
Contributions of cash, material, equipment, construction, labor, and securities by States, local governments, individuals, associations, and private corporations in aid of construction	63,000,000
Loans by Federal Government in aid of construction of Pacific railroads	48,000,000
Loans by States and local governments in aid of construction	46,000,000
Guaranty or endorsement of railroad bonds by States and local governments	25,000,000
Tax-exemption aid to railroads by States and local governments	13,000,000
Aids to railroads by States through grants of banking privileges	1,000,000
Subscriptions to railroad stocks and bonds by States and local governments	50,000,000
Collective subscriptions to railroad stocks by citizens	87,000,000
Vacation of streets to railroads	77,000,000
Rights in public domain	118,000,000
Total	$1,282,000,000
B. Aids given from World War to 1936:	
Loans by Reconstruction Finance Corporation	115,000,000
Loans by Federal Emergency Administration of Public Works	46,000,000
Total	$ 161,000,000
Grand total, all aids to railroads	$1,443,000,000

As this table indicates, an overwhelming proportion of the public aid which has been given to railroads represents aids to secure construction and is of historical rather than current interest. While these aids conferred large benefits on the railroads at the time they were being granted, they do not, for the most part, operate to provide benefits for the owners of railroads today. The significant aid which is being currently rendered consists largely of Reconstruction Finance Corporation loans. The financial plight of the railroads in recent years has led some railroad spokesmen to press for outright government subsidies to provide for maintenance and upkeep. Such subsidies are defended on the ground of public interest in an adequate transporta-

tion service. Up to this time the drive for subsidies has enjoyed no success, and the main efforts of railroad protagonists have gone into campaigns to limit alleged aids which the government makes available to competitors of the railroads and to impose equality of regulation on other forms of transportation.

PUBLIC AID TO WATER CARRIERS

Public aid to water carriers has been extended largely in the form of government improvement and maintenance of waterways. Government expenditures on this form of assistance began early. Between 1827 and 1866 the federal government granted 6,340,339 acres of public lands in aid of canal building or river improvements, in addition to right-of-way grants. State expenditures on waterway improvements started even earlier. The initiation of construction work on the Erie Canal in 1817 inaugurated an era of canal "mania" which reached its height in the decade between 1830 and 1840 and began to decline with the expansion of rail transportation.

In the period between the Civil War and the turn of the century, inland waterway transportation languished, chiefly as a result of the powerful competition offered by the railroads. Meanwhile, expenditures on internal waterway improvements also declined. Toward the end of this period, dissatisfaction with railroad rates and a belief that water transportation could provide cheaper service and operate as an effective regulator of railroad rates led to a revival of interest in water transportation. As a result, large expenditures were made on waterway improvements, particularly in the period since 1910. As of June 30, 1936, actual federal expenditures for river and harbor improvements within the continental United States aggregated $2,138,756,203.[16] This figure does not include federal expenditures for water terminals, which approximated $166,000,000 up to June 30, 1932, or expenditures for various aids to navigation such as lighthouses, which have also been not inconsiderable. In addition, total state and local expenditures for canals, terminal facilities, and other waterway improvements amounted to more than $1,250,000,000.[17] The "annual cost" of all waterway and terminal improvements in 1935 has been estimated as about $145,000,000.[18]

[16] *Ibid.*, p. 20.

[17] *Ibid.*, p. 20.

[18] *Ibid.*, p. 22. "Annual costs" include maintenance and operation expenses, interest charges, and provisions for amortization.

The benefits conferred by these expenditures do not lend themselves to precise measurement. But one clear result of the waterway improvements of the last three decades is a reinvigorated water carrier industry.[19] Between 1916 and 1937, for example, the number of carriers using the Mississippi River system increased from 138 to 389, and the growth of investment in facilities has been even more impressive. On the whole, private and contract carriers have benefited more than common carriers, judged in terms of earning power. Common carriers have encountered financial difficulty, and the Inland Waterways Corporation, a government enterprise which conducts the largest operations, has not paid its way.

Perhaps the most significant result of recent public aids to water transportation has been the regulatory impact of water carrier competition on the structure of railroad rates in the affected areas. Benefits in rate reductions have accrued to shippers in a position to avail themselves of water facilities; at the same time, competitive handicaps have also been placed on shippers without access to waterways. Railroad resentment against alleged "subsidization" of water carriers has produced demands that tolls be imposed on the use of water facilities, but so far with no result. Railroad pressure, however, contributed significantly to the enactment of the Transportation Act of 1940, which provided for more comprehensive regulation of water carriers and vested the Interstate Commerce Commission with additional power to adjust the competitive relationships between railroad and water carriers.[20]

PUBLIC AID TO MOTOR CARRIERS

One of the most intensively debated issues in the transportation field in recent years has been the question of whether motor carriers have or have not received public aid. Railroad spokesmen have argued that the vast expenditures on public highways in the last two decades constitute a direct subsidy to the motor carrier industry; representatives of motor carriers have replied that their industry has, through registration fees, gasoline taxes, and other charges and payments which have gone into the construction of public roads, met all the costs properly attributable to it. In the confusion of charge and

[19] Considerable improvements in the design and construction of inland waterway vessels have undoubtedly contributed to this reinvigoration.

[20] See Chapter 9.

countercharge, it has thus far been impossible to achieve any reconciliation between the two opposing points of view.

The studies sponsored by the Federal Co-ordinator of Transportation, perhaps the most careful investigation yet made, indicate that "motor-vehicle users as a class have paid their way since 1927."[21] Comparisons of costs and payments for different vehicle groups were made for the years 1932 and 1937. The results for the year 1932 were summarized as follows:

(1) Passenger cars slightly more than discharged their responsibility for road and street costs.
(2) All busses, except school busses, met their responsibilities. Payments by the group of largest busses exceeded assigned costs by large margins. . . .
(3) . . . Payments by users of farm trucks fell 14 per cent below the assigned costs.
(4) The 1½ ton and less truck used in private operations met only 70 per cent of the costs assigned to it; the corresponding group in the for-hire field met only 78 per cent. Trucks larger than 1½ tons rated capacity generally discharged their obligations; in some cases payments considerably exceeded assigned costs. . . .[22]

Findings for the year 1937 did not materially depart from this pattern. These studies would seem to indicate that, at least during the period studied, the motor carrier industry as a whole was not the recipient of any form of public subsidy. This does not, of course, mean that the industry did not benefit from highway improvements. Indeed, the whole development of motor transportation would have been impossible without extensive expenditures on road and street construction.

PUBLIC AID TO AIR CARRIERS

The real beginnings of the air transport industry in the United States date from the passage of the Air Mail Act of 1925. Between 1918 and 1926 the air-mail service was operated directly by the Post Office Department. The Act of 1925 provided for the retirement of the Post Office from flying activities and the awarding of mail contracts to private companies by competitive bidding. At the beginning, payments were limited to a maximum of four fifths of air-mail revenue; no subsidy was envisaged. Subsequently, the basis for pay-

[21] *Ibid.*, p. 26.
[22] *Ibid.*, pp. 26–27.

ment was changed to increase compensation to the carriers and air-mail postage rates were reduced. As a result, payments to air-mail carriers exceeded estimated air-mail revenue in 1929 by nearly $7,000,000; in 1929 this figure increased to $9,345,000. Despite these aids, certain of the mail contractors and most of the nonmail carriers faced serious operating deficits early in 1930, and widespread abandonment of services was threatened.

In 1930 Congress enacted the Watres Act. This law provided for the issuance of route certificates in place of the old air-mail contracts. It also established a new formula for mail payment which provided more liberal compensation and which was designed to encourage passenger traffic. The passage of the Watres Act created an active demand for new service, and payments to air-mail carriers mounted from nearly $17,000,000 in 1931 to nearly $20,000,000 in 1932 and $19,500,000 in 1933.

Charges of collusion between the mail carriers and the Post Office officials of the outgoing administration led to the cancellation of all air-mail contracts in 1934. After a short interval during which the Army flew the mails, the Air Mail Act of 1934 restored contract operations under competitive bidding. The level of compensation was lowered and a statutory maximum of 40 cents per plane mile was imposed. Payments to air-mail carriers exceeded estimated postal revenue for the four years from 1935 through 1938 by only a little more than $4,000,000; total payments to air-mail carriers increased from $9,000,000 in 1935 to a little over $14,000,000 in 1938.

Heavy losses suffered by the air transport industry again produced a demand for more favorable legislation, and Congress responded by passing the Civil Aeronautics Act of 1938. A new Authority was set up with extensive power to regulate the air industry and to promote its development. Air-mail payments were again liberalized, and the Authority was given broad power to adjust payments to the needs of different classes of carriers. Total payments to air-mail carriers amounted to a little over $16,500,000 for the fiscal year 1939, and the appropriation for the next fiscal year increased still further to approximately $18,000,000. In 1940 the domestic air transport industry remained dependent on mail revenues for profitable operation. The percentage, however, of total revenues represented by mail pay has been steadily decreasing, and some of the stronger companies appear to be approaching the point where they will be in a position to realize substantial profits without mail subsidies.

Aid to the air transport industry has, of course, not been confined to mail payments. Federal, state, and local governments have all made extensive expenditures on airports, airways, and related services. Estimates of total public aid rendered to the air transport industry in the period 1926–38 indicate expenditures of approximately $120,431,000.[23] This sum is in addition to another $50,000,000 which represents public aid conferred on civilian users of aircraft other than scheduled air carriers. These expenditures will probably greatly increase as the air transport industry expands and the collateral national defense benefits of such improvements are emphasized.

THE PATTERN OF PUBLIC POLICY

This history of public aids to transportation reveals an interesting pattern. In each case public aid has been highly important in the development stages of the industry; in each case the extension of public aid has been followed sooner or later by regulation. In the case of the railroads, aid was withdrawn as the industry expanded and grew prosperous, only to be renewed again as the industry entered a stage of decline and difficulties. The renewal of aid to water carriers developed as an offset to the power of the railroads, though local vested interests supported its continuation as a bargaining weapon long after the monopoly position of the railroads had been undermined. In the case of motor carriers, the tendency has been to increase taxes and payments to the point where it becomes highly questionable whether any form of public subsidy is being received. Air carriers are still predominantly in a developmental and subsidy-receiving stage, though already tendencies toward increasing regulation and restriction of direct subsidies have begun to appear. The competitive relationships among different types of carriers makes public aid to any of them suspect to all the others; at the same time, each presses for maximum favorable treatment. In this context, public policy wavers between aid and regulation, though the long-term trend appears to be toward over-all control and co-ordination in order to achieve necessary adjustments which will contribute to the general welfare.

5. General Services for Business

The Department of Commerce was authorized by its enabling act of

[23] *Ibid.*, p. 160.

1903 "to foster, promote, and develop the foreign and domestic commerce, the mining, manufacturing, shipping, and fishing industries, and the transportation facilities of the United States." In discharging these responsibilities, the department has become a general service agency for American business ministering to the needs of its special clientele just as the Departments of Agriculture and Labor do to theirs. In carrying on its service functions, the Department of Commerce operates chiefly through the Bureau of Foreign and Domestic Commerce and the Bureau of Standards.

The present Bureau of Foreign and Domestic Commerce was established in 1912. While its work grew steadily during the next decade, its real expansion began when Herbert Hoover became Secretary of Commerce in 1921. Expenditures increased from $860,000 in 1920 to over $5,000,000 in 1932; personnel quintupled. Under Hoover's leadership, the primary emphasis of the Bureau's work was on the expansion of foreign trade. Close relationships were developed with businessmen and leading trade associations; district offices were opened throughout the United States; and over fifty foreign offices were established. Foreign representatives of the Bureau zealously sought out trade opportunities in the most remote corners of the world; representatives at home brought them to the attention of businessmen. All business requests for information or advice and assistance received careful attention by the Bureau, and its growth met enthusiastic support from leading business organizations.

With depression, the collapse of foreign trade, and foreign debt defaults, the Bureau's expensive promotional work in the foreign trade field began to be more critically appraised. Under the New Deal, the number of offices abroad was drastically reduced, and on July 1, 1939, the remaining personnel of the Bureau's Foreign Commerce Service was transferred to the Department of State. Funds available to the Bureau have, meanwhile, also shrunk. For the fiscal year 1940–41 appropriations were $2,163,000, considerably less than half of the 1932 total. While the Bureau continues to carry on promotional work in behalf of American business firms, the accent of its activities has been shifted. More attention is being paid to problems of domestic trade and to broader and more fundamental research such as national income studies, investigations of interstate trade barriers, improvements in reporting of inventories, problems of small businessmen, and surveys of developing maladjustments in the economy. The present program of the Bureau thus goes beyond as-

sistance in solving the business problems of individual firms; it is increasingly directed to the "larger needs of the economy" and is designed "to assist all policy makers, whether of business or Government, by indicating the significance of current and proposed policies in the light of underlying developments." [24]

The National Bureau of Standards also serves business enterprise. Established originally to maintain national standards of measurement, the Bureau's functions have broadened out over the years to include a vast amount of scientific and industrial research in many fields. Under Hoover, the primary stress was on industrial research. As in the case of the Bureau of Foreign and Domestic Commerce, intimate relationships were developed with industry. The facilities of the Bureau were made available to "research associates" sponsored by industrial groups, and the problems chosen for investigation were focused on commercial and industrial needs. As a result of Hoover's interest in the elimination of "waste in industry," much of the Bureau's time was devoted to so-called "simplified practice" work, which was designed to reduce waste by eliminating unnecessary variety in industrial products and specifications. Under the New Deal, much of this simplified-practice activity has been curtailed and the energies of the Bureau have been freed for other tasks. While aids to industrial research have been continued, the program of the Bureau also reflects new social needs. Thus, research is being pursued in the technical aspects of low-cost housing, and more extended analyses of the performance-standards of products and commodities are being undertaken, in order to provide greater services for consumers.

As these examples indicate, the position of the Department of Commerce as a service agency for business reflects the broader political context in which the department is compelled to function. Under Hoover, the department went through a period of extraordinary expansion and became a powerful engine of business promotionalism. With the advent of the New Deal, the service functions of the department were continued, but on a less grandiose scale and no longer with an eye singly to business needs. Yet, even under the New Deal the liaison function of the department as a connecting link between business and government persisted, and the department made strenuous efforts, through such agencies as the Business Advisory Coun-

[24] *Twenty-seventh Annual Report* of the Secretary of Commerce (1939), p. xvi.

cil,[25] to provide channels by which "the businessman's point of view" might be presented.

6. The Importance of Business Promotionalism

The preceding survey has emphasized the importance of special government aid in such areas as tariff policy, shipping, transportation, and the field of general governmental services for business. The assistance rendered in these areas has been highly useful to numerous business enterprises. There remain, however, many businessmen who have benefited little, if at all, by special governmental aid. Even in the areas where aid has been most important, the extent of governmental aid forthcoming has varied with the political strength which business groups have been able to muster.

Where business promotionalism has been carried to excess and produced abuses, the result has usually been to inspire counterorganization on the part of farmers, laborers, and other nonbusiness groups. As these groups have organized, they have become increasingly conscious of their political power. They have imposed brakes and restraints on business promotionalism in the form of regulatory controls. They have also awakened to a realization that they, too, could use government in positive fashion to promote their own interests.

[25] The Business Advisory Council was organized in June, 1933, by Secretary Roper in order "to make available to the Department of Commerce seasoned judgment and experience on matters affecting the relation of the Department and business." It consists of approximately fifty members, most of them leading businessmen, serving without compensation and meeting periodically to study departmental and general business problems.

Chapter Five. PROMOTION OF AGRICULTURE

The role of government as promoter of agricultural development is a relatively ancient one in this country. Beginning with a land policy designed to open up virgin areas for settlement and cultivation, expanding to provide farmers with information, education, and a wide variety of services, agricultural policy has gradually evolved a pattern of relationships which includes improved government farm credit facilities, the stimulation of agricultural co-operation, the imposition of regulatory controls on processors and handlers of farm products, emphasis on soil conservation and land-use planning, and reliance on a linked system of subsidies and production and marketing restraints to increase the farmer's share of the national income. Behind the evolution of these expanding controls is a long story of agitation and organization on the part of farm groups operating through both political parties, of a gradual turn toward collective action under the pressure of economic maladjustments, and of the slow acceptance of the major responsibilities which government has come to exercise in this area.

1. The Development of Governmental Services for Agriculture

Governmental interest in the improvement of agriculture was manifested early in our national history. "In 1839 Congress took the memorable step of appropriating $1000 to the Patent Office for collecting and distributing seeds, prosecuting agricultural investigations, and procuring agricultural statistics." [1] The year 1862 was particularly important in the evolution of agricultural policy. On May 15, 1862,

[1] A. P. Chew, *The United States Department of Agriculture*, p. 27.

the Department of Agriculture was created as a service agency for farmers. Five days later Congress passed the Homestead Act, which opened up the Western public domain for settlement. On July 2 came the enactment of the Land Grant College Act, which donated free land to the states for the establishment of colleges of agricultural and mechanic arts. This Act laid a basis for the system of close co-operation between the Department and the state agricultural colleges which has since developed. Under the Hatch Act of 1887, federal aid was extended to encourage more extensive agricultural research. The state agricultural colleges became centers for such activity.

With the spread of interest in scientific farming, attention turned to the possibility of extension work among the farmers themselves. Soon the agricultural colleges were sponsoring "farmers' institutes," "agricultural trains," and other forms of adult education in order to disseminate "correct agricultural principles." The Department of Agriculture, meanwhile, became interested in demonstration work in order to combat the ravages of the Mexican boll weevil in the Southern states; beginning in 1902, a number of agents were dispatched to Southern counties to carry on and supervise demonstrations. This work soon enlisted the enthusiastic support of the state agricultural colleges and local interested farm groups, and in the Smith-Lever Act of 1914 the county agent was made the basis of a federally aided system of extension education.[2]

Under the Smith-Lever Act county agents worked closely with the Department of Agriculture and the state agricultural colleges. Since the colleges were anxious to enlist local financial support and co-operation, arrangements were made by which the county agents were jointly selected by the state extension office and the county co-operating group. Thus, the county agent became, at one and the same time, a national, state, and local official. This highly interesting administrative expedient combined centralized supervision of standards with a form of decentralized administration which ensured actual personal contacts with farmers in practically every agricultural county in the country. The administrative machinery and contacts thus developed were to prove of invaluable assistance much later when the ambitious AAA experiments were initiated. Unlike the National Recovery Administration, the Department of Agriculture did not have to resort to improvisation. The way had been prepared for years. The agricultural colleges had fed competent personnel into the service; a tradition

[2] See Gladys Baker, *The County Agent* (1939).

of close working relationships with the states and localities had been built up, and the Department was firmly rooted in the support and understanding of its constituency.[3]

During this same period, the Department of Agriculture began to undertake regulatory duties of incidental benefit to farmers. The Meat Inspection Act of 1890, the Animal Quarantine Act of 1901, the Grain Standards Act of 1901, the Food and Drugs Act of 1906, the Plant and Quarantine Act of 1912, and the Federal Warehouse Act of 1916 marked only the beginning of a movement to extend the use of federal standards and inspection services which has since gone much further. While most of these services were originally initiated largely as marketing aids for farmers, their importance to consumers was to become increasingly apparent over the years. At the same time, other marketing services were provided. Crop reporting was expanded; under legislation adopted in 1916 funds were made available to the states for highway improvement and construction. In the same year, Congress created the system of Federal Land Banks which were to become the nucleus of the present Farm Credit Administration. On the eve of the American entrance into the first World War, the main emphasis of American agricultural policy was on expanding services to improve farming methods, on assistance in marketing, and on meeting the demand for improved long-term credit facilities.

2. War Boom and Postwar Depression

With the first World War came a real agricultural boom. The demands of the Allies for foodstuffs and cotton, the requirements of our own mobilized forces, and the needs of war-torn Europe in the immediate post-armistice years combined to send prices of crops and agricultural land skyrocketing dizzily upward. Wheat, which sold for 93 cents a bushel in 1913, climbed to $2.76 a bushel in 1919; in the same period corn rose from 70 cents to $1.59; and cotton went up from 13 cents a pound to 38 cents a pound. Marginal and submarginal land was opened up; American agriculture expanded as never before. Lulled by a false sense of security, American farmers borrowed money, bought land, turned to money crops, purchased machinery,

[3] The federal grants-in-aid authorized by the Smith-Hughes Act of 1917 and the George-Reed Act of 1929 for the promotion of vocational education in agriculture and home economics were also instrumental in developing working relationships between the federal government and the rural population. The personnel of the Smith-Hughes schools frequently exerted an influence almost as important as that of the county agent.

installed expensive improvements, and encouraged their localities to build roads and develop new services, all to the accompaniment of higher tax rates and increased governmental debt.

In the fall of 1920 the war boom broke. Crop prices dropped severely and land values plunged downward. The postwar deflation left the American farmer with overexpanded acreage and a heavy burden of debt and taxation. Faced with contracting economic vistas, farmers began to turn to government for relief. The first outlines of a bipartisan Farm Bloc appeared in Congress.[4] At first there was some tinkering with the tariff, but neither the Emergency Tariff Act of 1921 nor the Fordney-McCumber Act of 1922 proved very helpful. The War Finance Corporation sought to facilitate the disposal of agricultural products in the export market and helped to stabilize the farm bank and credit structure by making loans for agricultural purposes to livestock loan companies, co-operative marketing associations, and other financial institutions making agricultural loans.

Some effort was made to extend regulation over handlers and distributors of farm products. The passage of the Packers and Stockyards Act in 1921 was designed to establish reasonable rates and fair practices for services rendered in the handling of livestock and live poultry. The Grain Futures Act of 1922 provided for the policing of trading in contracts for future delivery. Through the Capper-Volstead Act of 1922 and the Co-operative Marketing Act of 1926, efforts were made to help farmers bargain more effectively with middlemen by facilitating the formation of agricultural co-operatives. The Agricultural Credit Act of 1923 supplied discount facilities in the intermediate credit field. But all of these measures, though useful in their respective ways, did little to ameliorate the consequences of the price collapse of 1920.

Agrarian leaders, arguing that farmers were not receiving "a fair share of the national income," began to search for some scheme which would boost prices and make government aid more directly available to farmers. A number of proposals were put forward to accomplish this purpose. One of the most popular was the equalization fee plan which was embodied in the McNary-Haugen Bill. Its aim was to secure world price plus tariff for the domestically consumed portions of export crops. Under this plan, a federal board was to be empowered to purchase enough agricultural products for sale abroad to raise the domestic price level above the world level by the amount

[4] See Arthur Capper, *The Agricultural Bloc* (1922).

of tariff duty on the product. The losses met with in the marketing of surpluses abroad were to be covered by an equalization fee to be collected from the growers. This proposal, which made no provision for control of production, won great favor among farmers. It was twice passed by Congress, first in 1927 and then in 1928, only to be vetoed on both occasions by President Coolidge.[5]

The second most popular plan of these years was the so-called export debenture plan. Its essential feature was the paying of a bounty on exports of farm products in the form of negotiable instruments called "debentures" which could be used by importers in paying customs duties. Under this plan, growers of staples entering the world market were, in effect, to be directly subsidized out of customs receipts. This plan was first introduced in Congress in 1926 and later reintroduced in 1928, but without success; efforts to add it as an amendment to the Smoot-Hawley Tariff Act also met defeat.[6]

Agrarian dissatisfaction, meanwhile, continued. President Hoover, following the suggestions embodied in the report of the Business Men's Commission on Agriculture,[7] took the line that the primary assistance which government could render agriculture was through improvement in the marketing machinery. The Agricultural Marketing Act of 1929 embodied this recommendation. A Federal Farm

[5] One of the most impelling reasons for the vetoes was put by Secretary Mellon as follows: "Foreign consumers under the proposed plan will secure American commodities at prices below the American level. European labor could purchase American products at a lower price and could live more cheaply than American labor. Foreign industrial costs would be lowered and the foreign competitor assisted in underselling American products abroad and in our home market." Quoted in John D. Black, *Agricultural Reform in the United States* (1929), p. 248.

[6] Another price-raising plan which was also discussed but met with much less favor was the so-called domestic allotment plan. Under this scheme domestic demand was to be segregated from the world market, and price in the domestic market was to be fixed at the world price plus the tariff duty on the commodity. Producers were to be allotted rights to sell specified portions of their crops at the protected domestic price; excess production had to be disposed of abroad at the going world price. This scheme did not provide the stimulus to production characteristic of the other plans; it involved a rigid control of domestic allotments for which farmers were not ready at the time. Consequently it was passed over, to be resurrected, at least in part, in the AAA when circumstances became more propitious. See John D. Black, *Agricultural Reform in the United States* (1929), Chapter X.

[7] See Business Men's Commission on Agriculture, *The Condition of Agriculture in the United States and Measures for Its Improvement* (1927). This Commission was established by the National Industrial Conference Board and the United States Chamber of Commerce.

Board was set up and provided with a revolving fund of $500,000,000. When price-depressing surpluses appeared on the market, loans were to be made available through co-operatives and so-called stabilization corporations to enable farmers to hold surpluses off the market. The hope was that the surpluses could be disposed of later as prices improved.

Unfortunately, the Farm Board experiment was launched at the worst possible time. Deteriorating economic conditions and growing world surpluses complicated the task of the Board immeasurably. The experiments with wheat and cotton were particularly disastrous. The Canadian Wheat Pool for several years had been trying to maintain world wheat prices by withholding wheat from the market; substantial surpluses from this source overhung the market when the Farm Board experiment was started. Operating through the Wheat Stabilization Corporation, the Farm Board entered the domestic market and loaned money on some 330,000,000 bushels of wheat. Though the temporary result was to peg the domestic price from 20 to 30 cents a bushel above the world price, the Wheat Stabilization Corporation was finally compelled to withdraw from the market, and the price of wheat dropped to a low of 57 cents a bushel. The experience with cotton was the same. Loans made at 16 cents a pound could not be continued; ultimately the price of cotton declined to less than 7 cents.

The result was large losses for the Farm Board. It became clear that price-supporting loans could not cope with the problem of mounting surpluses as long as there was no check on production. The Farm Board urged farmers to reduce their acreage, but persuasion proved futile. Glut induced more glut, and the more the farmers produced, the lower prices went. Meanwhile, industrial prices declined far less sharply than agricultural prices.

The farm depression had been bad before 1930; after that year it grew considerably worse. As the depression affected industry, the domestic demand for agricultural commodities fell off sharply. Foreign buying declined more than ever as purchasing power shrank, tariff barriers were raised, and other sources of supply were developed. It was argued that tariffs on imported manufactured goods should be reduced to stimulate foreign purchases of American agricultural products, but this course proved not to be politically feasible. The severe drop in prices made it impossible for many farmers to pay their debts. Wholesale foreclosures threatened. The failure of farm relief schemes resulted in dramatic incidents—farmers' holiday movements, the

dumping of milk, the tarring and feathering of lawyers who sought to foreclose mortgages, and the defiance of courts which ordered the sale of farms. It became clear that the country was faced with a very serious agricultural crisis. After the experience with the Farm Board, schemes for production control were winning wider agrarian support. The stage was set for government intervention on a grand scale when the new administration took office in 1933.

3. New Deal Agricultural Policy

THE AAA OF 1933

The Agricultural Adjustment Act, which was approved on May 12, 1933, involved sweeping innovations in the government's relation to agriculture. Its declared goal was to re-establish "prices to farmers at a level that will give agricultural commodities a purchasing power with respect to articles farmers buy, equivalent to the purchasing power of agricultural commodities in the base period—August, 1909–July, 1914." Its outstanding feature was emphasis on production control as a method of attaining this goal, though the Act also gave the President power to regulate the gold content of the dollar and made provision for an emergency farm mortgage refinancing program.[8] Production control was to be exercised through a variety of methods. Among them were contracts for restriction of acreage or output in exchange for benefit payments, commodity loans, marketing quotas and agreements, export subsidies, and direct purchase of surpluses. Under the original act the production control provisions applied only to wheat, cotton, corn, hogs, rice, tobacco, and milk. This list was expanded in 1934 to include rye, flax, barley, grain sorghums, cattle, peanuts, sugar beet, and sugar cane.

The contractual method of regulating output proved especially important in the case of wheat, cotton, hogs, and corn. Theoretically, co-operation on the part of farmers was voluntary. The farmer who did not want to adjust his production was under no compulsion to do so. But schedules of benefit payments were so arranged as to make it attractive for many farmers to co-operate. Such payments were financed from taxes levied on the processing of all commodities on which benefit payments were made. Taxes were measured by the difference between the actual price of agricultural commodities and the so-called parity or base price.

[8] See below, p. 127.

In the case of certain commodities, other methods of adjustment were utilized to supplement contracts. Price-pegging loans were made available to cotton and corn growers through the Commodity Credit Corporation. The Bankhead Cotton Control Act of 1934 and the Kerr-Smith Tobacco Control Act of the same year added a system of marketing control by levying a tax on all marketing in excess of prescribed quotas. This tax was designed to force a larger percentage of growers into the "voluntary contract" system. Emergency purchases of pigs and sows in 1933–34 and cattle and sheep in 1934–35 helped to reduce supplies and support prices.[9] Subsidies were paid on the export of wheat from Pacific Northwest ports. For milk and dairy products, marketing agreements between producers and distributors helped to introduce greater stability into a number of milk markets.

The way in which production control operated may be illustrated by the cotton program under AAA. Within a month after the passage of AAA, announcement was made of a cotton plow-up campaign which was designed to remove from production at least ten million acres of the more than forty million acres then in cultivation. Producers agreeing to take out of production not less than 25 per cent nor more than 50 per cent of their acreage were offered cash payments of $6.00 to $12 per acre, according to yield on the area withdrawn, plus options to buy government-owned cotton at 6 cents a pound; or simple cash payments (without options) of $7.00 to $20 an acre. Under this plan approximately ten and one half million acres were removed from farm production. Cash benefit payments, financed by a cotton processing tax, totaled about $113,000,000.

Under the influence of this program the price of cotton rose from the 1932 low of 5 cents a pound to over 9 cents a pound. An unexpectedly large yield on the reduced acreage in 1933 threatened, however, to depress prices again. To prevent a new decline, the government announced in October, 1933, that the Commodity Credit Corporation would make loans of 10 cents a pound to cotton producers on the unsold portions of their crops. With this price-pegging loan, the price of cotton climbed to over 10 cents a pound in January, 1934, and by the end of the crop year it exceeded 12 cents. Additional loans were made by the Commodity Credit Corporation which, in effect, pegged the price at 12 cents a pound. The 1934 cotton program was designed to withdraw fifteen million acres from production. Arrangements were made for continuing benefit payments to farmers.

[9] The 1934 drought also contributed to the curtailment of crops and a rise in prices.

This production control program was supplemented in 1934 by the Bankhead Cotton Control Act which provided for compulsory restrictions on the marketing of cotton and made provision for allotting to each farm an amount of cotton that might be marketed tax free.

Similar controls were put into effect for the 1935 crop. The loan rate, however, was reduced to 10 cents a pound because the high 12 cent rate had served to impound cotton in the loan and had interfered with exports as well as with domestic consumption. Growers co-operating in the control program continued to receive 12 cents a pound on all cotton sold within their allotments; government payments were arranged to make up the difference between the average market price and 12 cents. The result was a very considerable improvement in the position of the cotton farmer during these years.

Indeed, by 1935 the prospect for American agriculture generally appeared to be brightening. Though parity prices were not realized, the average of farm prices was 66 per cent higher than in 1932; total farmers' cash income had increased from less than $4,500,000,000 to $6,900,000,000; agriculture's share in the national income had mounted from 7½ per cent to approximately 10½ per cent. To be sure, not all the gains were equally distributed throughout American agriculture. Drought-affected areas in the Great Plains were in dire need. Tenant farmers and sharecroppers failed to participate in the general improvement. But, taken as a whole, farmers were considerably better off than on the eve of the New Deal.

On January 6, 1936, the Supreme Court handed down the Hoosac Mills decision invalidating the processing tax provisions of the Agricultural Adjustment Act of 1933.[10] While this decision did not affect the constitutionality of AAA marketing agreements, commodity loans, or surplus removal operations of the purchasing variety, it struck at the heart of AAA by stopping all adjustment programs dependent upon contracts with producers. Farm leaders were at first stunned, but efforts were promptly made to find some way of continuing benefit payments which would be unaffected by the Hoosac Mills decision. A new approach was found in a shift in emphasis from acreage control to soil conservation.

THE SOIL CONSERVATION AND DOMESTIC ALLOTMENT ACT OF 1936

Even before the Hoosac Mills decision, drought and dust storms had dramatized the need for soil conservation, and the Administra-

[10] *United States* v. *Butler*, 297 U.S. 1 (1936).

tion had announced its intention of putting greater emphasis on improved farm-management practices. The Soil Erosion Act of 1935 looked in this direction.[11] But it did not satisfy the demand for additional farm income. The Soil Conservation and Domestic Allotment Act, which was enacted February 29, 1936, sought to combine income payments with soil conservation. Among the objectives listed in the act was the re-establishment of the 1909–14 ratio of farm to nonfarm income. Five hundred million dollars were appropriated to make payments to farmers following approved conservation practices and abandoning "soil-depleting" crops such as wheat, corn, tobacco, and cotton in favor of soil-conserving grasses and other soil-building crops. Indirectly it was hoped that some production control in the basic crops could thus be achieved.

These hopes were to be disappointed. While the conservation aspects of the new program attracted considerable farmer participation, the fact remained that it was a very ineffective check on production. The first year under the new Act coincided with one of the worst droughts in the country's history. The result was to compel emergency changes in the conservation program, particularly in the corn belt, where the effects of the drought were most noticeable. With the return of normal weather in 1937 came better than average yields, and a sizable minority of non-co-operating farmers. The limitations of the conservation program were fully revealed. The cotton crop increased from approximately 10,500,000 bales in 1935 to nearly 19,000,000 bales in 1937. The crop carry-over proved almost large enough to take care of the next year's domestic demand. This same story of expanded acreage, increases in production, and huge carry-overs had its counterpart in wheat, corn, and other crops, and the same vicious spiral of crop surpluses and sharply declining prices was repeating itself all over again. Once more farmers were impelled to turn to plans for more rigid control of output.

THE AAA OF 1938

On February 16, 1938, the new Agricultural Adjustment Act became law. Its origins have been officially described as follows:

> The background of the new Agricultural Adjustment Act of 1938 might be said to consist primarily of three factors. The first of these was drought,

[11] See Chapter 20 for a more extended discussion of soil conservation and land-use planning.

which in 1934 and again in 1936 showed the need of an Ever-Normal Granary of larger reserve supplies of wheat and corn for food and feed. The second was the record crop of 1937 and the prospect of another big crop in 1938, a situation which threatened to ruin farmers with surpluses again. The third was the Hoosac Mills decision, which invalidated production control as a means of protecting farm prices. The Agricultural Adjustment Act of 1938 sought to meet the first two of these conditions by providing for an Ever-Normal Granary to store up larger reserves as added protection against drought, and to meet the third by substituting surplus control, that is, control of marketings in interstate commerce, for the production-control approach of the original adjustment act.[12]

The elements embodied in the new Act included provision for parity payments, conservation payments, acreage allotments to help stabilize production, loans to enable farmers to store carry-overs in surplus years, marketing quotas in time of emergency, crop insurance for wheat, and various surplus removal devices designed to increase domestic and foreign consumption.

The Agricultural Adjustment Act of 1938 authorized so-called price-adjustment or parity payments to be made to producers of corn, wheat, cotton, tobacco, and rice, when Congress shall make appropriations available for this purpose. These payments were intended to provide eligible producers with a return which "is as nearly equal to parity price [13] as the funds so made available will permit." In 1938, Congress appropriated $212,000,000 for parity payments; the next year appropriations were increased to $225,000,000; the 1940 Congress returned to the 1938 figure.[14]

[12] United States Department of Agriculture, *Agricultural Adjustment 1937–38* (1939), p. 18.

[13] Parity as applied to prices is defined by the Act as that price for the commodity which will give to the commodity a purchasing power with respect to articles that farmers buy equivalent to the purchasing power of such commodity in the base period. The base period is August, 1909, to July, 1914, except for tobacco where the base period is August, 1919, to July, 1929.

[14] Because of the uncertainty of annual appropriations, farm leaders have expressed an interest in modifying the law to put parity payments on a more permanent basis. Many farm groups favor the so-called "certificate" plan, by which farmers who co-operate with federal crop programs would be given "certificates" for the percentage of their crops expected to be consumed domestically. Purchasers of farm commodities would be required to pay the current market price of the commodity plus the certificate value. This plan would differ from the processing taxes of the first AAA in that no government appropriations would come out of the Treasury, but since added cost would presumably be passed on to the consumer it operates on the same general principle.

The Act of 1938 also continued the essentials of the earlier AAA soil conservation program. The amount of conservation payments was limited to $500,000,000 annually. Participation remained voluntary, though the conservation standards of the Department had to be met before farmers were eligible for benefit payments. Growers of cotton, corn, wheat, and rice were required to plant within their assigned acreage allotments in order to qualify for benefit payments under the conservation program. "Deductions from these benefit payments, and loss of eligibility for maximum commodity loans and for parity payments [were] provided for in cases of planting beyond the acreage allotments." [15] National acreage allotments were calculated to meet domestic, export, and reserve needs. These allotments were then broken down by states, counties, and individual farms. Allotments to the individual took into consideration tillable acreage, crop rotation practices, type of soil, and topography.

In order to protect farmers from excessively low prices in years of surplus, the Commodity Credit Corporation was authorized to make loans on the security of any agricultural commodity. The Corporation was specifically directed to make loans on cotton, corn, and wheat, when prices fell below or supplies exceeded levels indicated in the Act. Rates to co-operating farmers might vary from 52 per cent to 75 per cent of parity price, depending on price and supply factors.[16] These loans were designed not only to hold price-depressing influences in check but also to enable producers, without financial hardship, to carry over supplies from years of unusually large production to be marketed in years of crop shortage.

The provisions for marketing quotas applied only to cotton, wheat, corn, tobacco, and rice and could only be invoked when excessive supplies piled up and two thirds of the affected producers approved the imposition of quotas. If the required two-thirds majority was secured, the quota provisions applied to all producers, and sales in excess of quotas were subject to a penalty tax. To help farmers store surpluses in excess of their quotas, loans were made available in years when marketing quotas were imposed. No loans, however,

[15] *Agricultural Adjustment 1937–38*, p. 108.

[16] "Loans are to be offered to non-co-operating producers only in years when marketing quotas . . . are in effect, and then only on so much of their crop as, under the marketing quota, would be subject to a penalty if marketed. The rate of loans to non-co-operators is to be not more than 60 per cent of the rate of loans to co-operators in the conservation program." *Agricultural Adjustment 1937–38*, pp. 120–121.

could be offered in years when supplies reached levels at which the application of marketing quotas was authorized by the Act, but marketing quotas had been voted down in a producer's referendum.[17]

The Act also created a Federal Crop Insurance Corporation which was authorized to offer crop insurance to wheat farmers. The Federal Crop Insurance Corporation began its operations in 1939. During that year over 150,000 farmers took out insurance; about 45,000 collected indemnities. Under the Act, farmers could receive insurance coverage running from 50 per cent to 75 per cent of the average yield of their farms; premiums and losses were calculated in bushels of wheat. During the first year of the program, claims paid by the government totaled about 9,500,000 bushels; premiums paid in were less than 6,800,000 bushels. The net loss to the government totaled slightly less than $1,900,000. Officials of the Corporation, however, denied that the Corporation was intended to provide disguised subsidies; over the years they expected an approximate balance between indemnities and premiums. Thus far, the crop insurance plan has been applied only to wheat. The Federal Crop Insurance Corporation was instructed in 1938 to investigate its application to other crops, and bills to extend insurance to cotton and corn were pending in Congress in 1940.

The Act of 1938 also authorized the continuation and expansion of surplus removal operations which had been initiated earlier by the Federal Surplus Commodities Corporation. These operations, which were conducted by the Surplus Marketing Administration[18] (the

[17] "This provision is designed to protect the value of the commodity which constitutes the security for the Government loan, since unregulated and burdensome marketing would tend to force down the price of the commodity." *Agricultural Adjustment 1937–38*, p. 120. The Act provided that marketing quotas could not be applied to wheat and rice in 1938. The Secretary of Agriculture later found that marketing quotas on corn would not be required for the 1938 crop. Marketing quotas for cotton and tobacco were proposed and approved in 1938. The tobacco marketing restrictions of that year were involved in *Mulford* v. *Smith*, 307 U.S. 38 (1939), where the Supreme Court upheld the constitutionality of the marketing quota provisions of the Act.

[18] The Surplus Marketing Administration also administers the marketing agreement programs provided for in the Agricultural Marketing Agreement Act of 1937. These programs are of two types, one for milk and the other for such commodities as fruits and vegetables. The programs for milk "establish minimum prices which handlers in a marketing area are required to pay producers, and, in addition, provide for a method through which payments are made." The programs for commodities in the fruit and vegetable field regulate the volume or grades and sizes of commodities shipped out of a particular producing area. These programs were originally developed under the

successor organization of the FSCC), embraced, first, programs to encourage increased domestic distribution and consumption; second, domestic diversion and new use programs; and, third, export subsidy programs.[19]

Under the first, surplus farm products were purchased for use in free school lunches, for distribution to needy families through state welfare agencies, and for use under the Food Stamp Plan. Under the latter plan, which expanded remarkably after it was first put into effect in Rochester, N.Y., in May, 1939, families on relief could buy weekly, on an entirely voluntary basis, a minimum of $1.00 or a maximum of $1.50 worth of orange stamps for each member of the family. These stamps could be used to purchase *any* food at any grocery store. For every dollar's worth of orange stamps purchased, the relief family received free 50 cents' worth of blue stamps. These blue stamps were also accepted at any grocery store, but could only be used to purchase foods designated as in "surplus" by the Secretary of Agriculture. Grocers receiving such stamps deposited them in their banks, which in turn received payment from the federal government. The plan proved popular both with grocers and relief clients. The food trades were pleased to have surplus distribution routed through commercial channels, while relief clients enjoyed the satisfaction of being able to select the commodities they wanted from among the surplus commodities available. The result was a domestic two-price system under which the consumption of surplus products by low-

Agricultural Adjustment Act of 1933. Constitutional doubts and enforcement difficulties led in 1935 to extensive amendments of the original act and further clarification in the Act of 1937. Present legislation provides for both marketing agreements and orders. Marketing agreements are voluntary arrangements entered into between the Secretary of Agriculture and handlers of any agricultural commodity. Orders apply only to specific commodities such as milk, fresh fruits, and vegetables, and may only be issued by the Secretary if certain stipulations are met. Orders with marketing agreements may be issued if handlers of 50 per cent of the volume of the commodity agree, and if the order is approved by two thirds of the producers (computed either by number or by volume). In special cases, orders may be issued without the approval of 50 per cent of the handlers. The constitutionality of the Agricultural Marketing Act of 1937 has been upheld as applied to milk markets in *United States* v. *Rock Royal Co-operative*, 307 U.S. 533 (1939) and *H. P. Hood and Sons* v. *United States*, 307 U.S. 588 (1939).

[19] See *Report* of the Associate Administrator of the AAA, in charge of the Division of Marketing and Marketing Agreements, and the President of the Federal Surplus Commodities Corporation, 1939, pp. 4ff.

income consumers in the United States was, in effect, subsidized by the government.[20]

The Act of 1938 authorized the Secretary of Agriculture to establish four regional laboratories to develop new uses to extend the market for farm products. Programs designed to encourage the use of cotton for highway construction and to replace jute bagging as a covering for cotton bales, and by-product uses for peanuts in peanut oil and meal, represented examples of efforts which were being made to find new outlets for surpluses.

Surplus disposal was also promoted through the use of export subsidies. During the period 1938–40, export subsidies were confined to wheat and cotton. Out of the 118,000,000 bushels of wheat exported in the fiscal year ending June 30, 1939, approximately 98,000,000 bushels were moved through the subsidy program at a cost to the government of about 27.4 cents per bushel. Beginning in July, 1939, export subsidies were also applied to cotton.[21] War exigencies and resulting trade dislocations after 1939 served to curtail foreign outlets and to compel virtual abandonment of the export subsidy program.

Experience with the agricultural controls provided by the Act of 1938 is still too brief to furnish a satisfactory test of their efficacy. When the Act was passed tremendous surpluses overhung the market; despite sizable reductions in acreage, surpluses in 1940 still remained a serious problem. With foreign demand for export crops such as wheat and cotton drastically reduced, crop carry-overs continued at record or nearly record levels. Only the supporting influence of government loans prevented prices from dropping to the levels of 1931 and 1932. Farm prices and farm income remained well below parity. But the combined effect of conservation and parity payments and loan programs assured co-operating growers of export crops prices well above those prevailing outside of the United States. During the years 1938–40 the cash farm income from marketings and government

[20] Between May, 1939, and June 30, 1940, the Food Stamp Plan was extended to 123 cities or areas. Plans at the beginning of the 1940–41 fiscal year called for further extension to a total of more than 150 cities or areas by the end of that period. "Up to May 1, 1940, expenditures for surplus foods with blue stamps issued by the Department of Agriculture had a value of approximately $10,400,000." See U.S. Department of Agriculture, Press Release, May 16, 1940.

[21] In 1939 a barter agreement with the British government was executed by which 690,000 bales of government-held loan cotton were exchanged for 80,000 tons of rubber.

payments averaged over $8,000,000,000 annually, a figure nearly double the low of 1932.

War problems complicated the task of AAA planners. The impact of war was variously felt in different branches of American agriculture. Growers of export crops such as wheat, cotton, and tobacco were adversely affected, and it appeared unlikely that expansion of domestic demand for these commodities would be sufficient to compensate for the loss of export outlets. On the other hand, the industrial expansion accompanying the defense program operated to stimulate the domestic demand for dairy and poultry products, meat, wool, some fruits, and vegetables. AAA policies were compelled to take account of these changes in the pattern of domestic and foreign demand; to the extent that AAA controls proved flexible, the strains and tensions of the resulting readjustments promised to be eased.[22]

4. Farm Credit and Farm Security

Government activity in the farm credit field began long before the New Deal. After years of complaint from farm groups that interest rates on farm loans were too high, terms too short, and sources of credit undependable, Congress in 1916 enacted the Federal Farm Loan Act. This Act marked a compromise between representatives of two schools of thought—those who sought to build up a co-operative system of rural credit patterned after European models and those who proposed the establishment of additional private credit institutions run on a profit basis under government supervision. Concessions were made to both; the Act as finally passed provided a dual system for supplying long-term mortgage loans. The co-operative part was composed of twelve federal land banks organized around associations of borrowing farmers. The private part consisted of joint stock land banks, which were privately owned institutions operating for profit.[23] Both parts of the system were placed under the general supervision of the Federal Farm Loan Board.

The unique feature of the land bank system was the farm loan association which formed its base. These associations were made up

[22] See United States Department of Agriculture, *Regional Adjustments to Meet War Impacts,* 1940.

[23] After a period of rapid expansion many of the joint stock land banks encountered serious difficulties. In 1933, arrangements were made for their liquidation under the supervision of the Farm Credit Administration.

of farmer borrowers who were required to subscribe to stock of the association to the extent of 5 per cent of their loans. The farm loan associations then endorsed and sold mortgages to the federal land banks and were required to purchase stock in these banks to the extent of 5 per cent of the loans sold. The initial investment of the government in the capital stock of the land banks was thus retired as the stock purchased by the farm loan associations increased. Bonds sold to obtain funds for the land banks were tax exempt and could be disposed of at relatively low interest rates. The interest rate charged by land banks was set by law at 1 per cent above the rate of interest on the last issue of bonds sold by the bank. The result was a considerable reduction in prevailing interest rates in the long-term farm mortgage field. By 1929 the land banks held mortgage loans totaling $1,200,000,000, about 15 per cent of the total farm mortgage debt.

The activities of the land banks were limited to the long-term field. Farmers interested in obtaining short- or intermediate-term loans to aid in the harvesting or marketing of their crops had to turn elsewhere. To improve credit facilities in this area, Congress in 1923 provided for the establishment of twelve Intermediate Credit Banks operating under the general supervision of the Farm Loan Board. These banks, unlike the land banks, were wholly owned by the federal government. Funds necessary to carry on lending operations were obtained through the issue of short-term, tax-free bonds, secured by farm paper in the bank's portfolio. These banks, however, did not deal directly with individual farmers. They operated as banks of discount for co-operative marketing associations, co-operative livestock companies, and rural banks. In recent years they have been principally engaged in discounting paper for production credit associations and banks for co-operatives.[24]

Thus, prior to the depression, the outlines of a government-sponsored farm credit system were already clearly discernible. With the onrush of depression, the whole farm mortgage structure was threatened. The precipitous drop in farm income left farmers helpless even to meet interest payments on their debt. Country banks and joint stock land banks failed; insurance companies and federal land banks found themselves hard pressed. Foreclosures and forced sales increased tremendously. In the latter days of the Hoover administration some steps were taken to relieve distress. The Farm Board made loans to agricultural co-operatives. In 1932 the directors of land banks were

[24] See below, p. 128.

authorized to give extensions to worthy borrowers; in order to support the land banks, Congress provided for the purchase of $125,000,000 of their stock. The Department of Agriculture made "emergency" crop, feed, and seed loans. The Reconstruction Finance Corporation organized twelve Regional Agricultural Credit Corporations to help refund short-term indebtedness. But the magnitude of the disaster outstripped these expedients.

THE NEW DEAL AND FARM CREDIT

Faced by emergency, the Roosevelt administration took drastic steps. All existing agricultural credit agencies were consolidated into the Farm Credit Administration by executive order dated March 27, 1933. The Emergency Farm Mortgage Act of May 12, 1933, provided for a large-scale program of farm debt refinancing. Payments on principal of land bank loans were postponed for a period of five years for borrowers in difficulties, provided interest and taxes were not in default. Rates were reduced to 4½ per cent and were subsequently lowered to 3½ per cent, where they have since remained. The Reconstruction Finance Corporation was authorized to make $200,000,000 available for so-called Land Bank Commissioner Loans. These loans, which were limited to $5,000 (later $7,500), could be made on either first or second mortgages, and might approximate 75 per cent of the "normal" appraised value of farm property.[25] Subsequently, additional funds were made available for Land Bank Commissioner Loans through the Federal Farm Mortgage Corporation established in 1934.[26] At the high point in 1936, $836,778,000 of such loans were outstanding. On December 31, 1939, the amount had been reduced to $691,000,000 and very few new loans were being made. On the same date, federal land banks held farm mortgages in the amount of $1,905,000,000. Altogether, federal agencies accounted for approximately 40 per cent of the total farm mortgage debt.

In addition to the emergency provisions noted above, steps were taken under the Farm Credit Act of 1933 to provide a short-term credit system analogous to the Land Bank system in the long-term field.

[25] The Federal Land Banks were restricted to first mortgage loans and a maximum of 50 per cent of the value of the land and 20 per cent of the value of permanent improvements.

[26] In 1934 and 1935, when Federal Land Banks were encountering difficulty in borrowing money at low rates, the Federal Farm Mortgage Corporation rendered assistance by selling its own guaranteed bonds in the market and purchasing land bank bonds.

This system consisted of twelve production credit corporations—one in each federal land bank district—and over five hundred production credit associations, located in scattered agricultural districts in the United States. The production credit associations occupied the same place in the production credit system which the farm loan associations occupied in the land bank system. They consisted of local co-operative organizations of farmers and stockmen who obtained their short-term credit requirements from the associations. Loans made by the associations were discounted with the Federal Intermediate Credit Bank of the district.

The production credit corporations performed three major functions for the local production credit associations: (1) they gave aid in organizing them; (2) they assisted in capitalizing them by buying preferred capital stock in the local associations; and (3) they supervised the operations of production credit associations. As a result of the stimulus given by these production credit corporations, the number of local production credit associations grew rapidly. As of December 31, 1939, they had nearly $155,000,000 in loans outstanding. Many of them were set up where local country banks had gone out of existence; others entered into active competition with the country banks. By legal regulation, production credit associations could not charge a rate of interest more than 3 per cent above the discount rate of the Federal Intermediate Credit Bank. The prevailing rate for most of 1939 was 4½ per cent.

In addition, the Farm Credit Act of 1933 also established a system of banking for co-operatives. This system consisted of a Central Bank for Co-operatives and twelve district banks. Ordinarily, the credit needs of most co-operatives were met by the district banks; the Central Bank served co-operatives of national or regional scope and sometimes also participated in the larger loans of district banks. At the close of 1939, loans outstanding totaled a little over $76,000,000. Loans were made for both short and long periods, and interest rates ranged from 1½ per cent to 4 per cent, depending upon the nature of the loan. Co-operative paper was discounted with the Federal Intermediate Credit Banks.

The steady extension of government activity in the sphere of farm credit carried with it a number of problems. As government lending increased, the terms and conditions of loans became, perhaps inevitably, political questions. Congressmen and Senators from rural areas showed considerable disposition to make political capital out of low

interest rates. In 1935 rates on land bank loans were forced down to 3½ per cent, over the bitter opposition of the Farm Credit Administration. Even with current low rates in the money market, the result was to use the land bank system as a vehicle for providing farm subsidies. Moreover, as government interest rates were forced down, existing private agencies making agricultural loans found it increasingly difficult to compete. Should they be driven from the field, the pressure on government to expand its activities would necessarily increase.

Of the total of $691,000,000 in Land Bank Commissioner Loans outstanding at the end of 1939, approximately 29 per cent were delinquent. Since most of these emergency loans were admittedly bad risks when made, and Congress realized that losses would be suffered when the loans were authorized, the rate of delinquency was no reflection on the Farm Credit Administration. Delinquency rates were a response to continued farm distress. The question, nevertheless, remained as to whether the Farm Credit Administration ought to follow a lenient or strict collection and foreclosure policy. The incorporation of the Farm Credit Administration in the Department of Agriculture in the spring of 1939 [27] and subsequent changes in the top personnel of the agency pointed in the direction of greater leniency and of a fusion of loan policies with the broader agricultural objectives of the New Deal.[28]

While the Farm Credit Administration helped to provide improved credit facilities for many farmers, there remained large disadvantaged agricultural groups such as tenants and sharecroppers, farm laborers, and owner-operators handicapped by heavy debt burdens, small holdings, or location on submarginal land, who were unable to qualify for assistance under the FCA program. With these groups in mind, President Roosevelt in 1936 appointed a special Committee on Farm Tenancy to investigate the problem and bring in recommendations for legislation. The findings of the Committee were revealing.[29] Farm tenancy had increased from 25 per cent of all farmers in 1880 to 42

[27] Provided for in Reorganization Plan #1, dated April 25, 1939.

[28] See Harold W. Torgerson, "Agricultural Finance in the United States," 16 *Journal of Land and Public Utility Economics,* 320 (August, 1940). The Secretary of Agriculture, in a statement on March 26, 1940, approved the major features of bills pending in Congress providing for a more lenient foreclosure policy, a guarantee of federal land bank obligations by the government, the elimination of ownership of capital stock by borrowers, and provisions for reduction in debt.

[29] *Farm Tenancy,* Report of the President's Committee, 1937.

per cent in 1935. In parts of the South the proportion was over 60 per cent. In the preceding ten years, farm tenancy had been growing at the rate of 40,000 per year. In addition, more than one quarter of all persons gainfully employed in agriculture in 1930 were farm laborers. Migratory laborers were on the increase; their precarious situation created new problems which were effectively dramatized in John Steinbeck's widely read novel *The Grapes of Wrath*.[30] Approximately a half million farm families located on submarginal land faced impoverishment. Thousands more owned holdings too small to provide an adequate standard of living. Other thousands were so hopelessly in debt as to face imminent loss of their farms.

The President's Committee on Farm Tenancy recommended action along four main lines:

(1) assistance in the form of liberal credit to enable tenants to purchase farms;

(2) modest loans to prevent small owners from slipping into tenancy, and to help tenants and sharecroppers to increase their standard of living and begin the climb toward land ownership;

(3) retirement of submarginal land by public agencies and assistance to enable families living on such land to find homes on good land;

(4) co-operation with state and local agencies of government to improve the general leasing system regulating relationships between landlords and tenants.

The Bankhead-Jones Farm Tenant Act of 1937 sought to carry out some of these recommendations. It authorized a long-term tenant purchase program. It also provided for continuation of the relief and rehabilitation program carried on earlier by the Resettlement Administration and its predecessor, the Rural Rehabilitation Division of the Federal Emergency Relief Administration. Finally, it provided for completion of the homestead projects initiated by the Resettlement Administration. No new projects were authorized.[31]

[30] In 1940 the House of Representatives authorized the appointment of a Select Committee to Investigate the Interstate Migration of Destitute Citizens. See *Hearings on Interstate Migration,* 76th Cong., 3rd Sess., pursuant to House Resolution 63 and House Resolution 491.

[31] These projects are of various types, ranging from subsistence homesteads to full-time farms. Some are for former residents on submarginal lands; some are for tenants in near-by areas; others are occupied by ex-coal miners and other stranded population groups. In addition, there are three suburban housing developments known as Greenbelt communities. Congress has ordered that the Farm Security Administration

Administration of the Act was vested in the Farm Security Administration of the Department of Agriculture. Ten million dollars was made available for the tenant purchase program the first year, \$25,000,000 the second year, and \$40,000,000 for the fiscal year 1939–40. The terms of the loans were unusually liberal. Loans could be granted in amounts almost equaling the full value of the farm to be purchased; the rate of interest was 3 per cent; the repayment period might extend over forty years with provisions for variable payments in accordance with farm conditions. The Farm Security Administration was swamped by applications; available funds made it impossible to meet more than a small proportion of the demand.[32]

The rehabilitation program of the Farm Security Administration had a wider reach. The total of \$280,837,768 in loans outstanding on June 30, 1939, represented 589,046 individual cases. Under this program, loans were limited to families on relief or near relief who were unable to obtain adequate financing from any other source. Loans were made for the purchase of supplies, equipment, and livestock, for the refinancing of indebtedness, and for family subsistence. Each loan was accompanied by supervision on the part of an FSA representative to make certain that the recipient carried out a farm and home management plan which was agreed to when the loan was granted.[33] Loans averaged about \$400, drew 5 per cent interest, and ran from

divest itself of ownership of these activities. Transfer of title to co-operative associations of settlers is contemplated.

[32] Critics of the law stressed the inadequacy of appropriations in terms of the magnitude of the problem. "If the appropriations reach \$50,000,000 per year, and 5 per cent of this amount is used for administrative purposes, 12,125 loans averaging \$4,000 could be made each year. This number would be less than one half of 1 per cent of the tenants and sharecroppers in the United States in 1935. Between 1920 and 1930 there was an increase in the number of tenants and sharecroppers of more than 20,000 per year, and this rate was practically doubled from 1930 to 1935. It is apparent, therefore, that more than \$50,000,000 per year is necessary in order to prevent tenancy from increasing, unless there are other factors which will materially reduce the rate of growth characteristic of the past fifteen years." See J. G. Maddox, "The Bankhead-Jones Farm Tenant Act," *Law and Contemporary Problems,* Vol. 4, p. 451 (October, 1937).

[33] "A typical farm-and-home management plan calls, first of all, for the raising of enough vegetables and livestock to meet the family's own subsistence needs. A canning budget is devised to provide a balanced adequate diet through the winter months. Acreage is set aside for the production of feed for the work animals and other livestock. The remainder of the farm enterprise is devoted to diversified production of livestock, livestock products, and cash crops." See *Report of the Secretary of Agriculture,* 1939, p. 68.

one to ten years. In addition, the Farm Security Administration fostered the voluntary adjustment of farm indebtedness and made loans available for co-operative medical care and community services such as pooled breeding stock or heavy machinery. In special cases of destitution, outright subsistence grants were distributed. During the fiscal year ending June 30, 1939, $22,758,000 was disbursed in this form.

While existing data do not permit a satisfactory appraisal of the state of the Farm Security Administration's rehabilitation loans, it has been estimated that at least 80 per cent of the amount of money lent will be repaid. A survey made at the end of the 1938 crop year indicated that "throughout the country, except in areas suffering from drought and other natural catastrophes, standard rehabilitation clients have increased their home food production, farm diversification, working equipment, living standards, and total net worth." [34] In thus enabling many indigent farm families to become self-supporting, the Farm Security Administration has provided a measure of security for underprivileged farmers which has hitherto been unavailable.

5. The Problem of American Agriculture

The basic problem of American agriculture can be stated simply. Loss of foreign markets, declining domestic demand because of industrial depression, a productive output greatly in excess of effective demand, increased costs in many areas because of soil erosion and depletion, and a disadvantageous ratio between the prices of farm and industrial products have combined to produce low farm income. The New Deal's efforts to cope with this problem have involved an attack on many fronts, but the chief reliance has been placed on a combination of subsidies and efforts to control agricultural output. Curtailment of output began with the Act of 1933, was in large part abandoned in 1936, and has been at least partially in effect since 1938. Subsidies have been used since the beginning of the New Deal for a variety of purposes—to enhance farm income, to foster soil conservation, to increase exports, and to encourage domestic consumption of surplus products by low income groups. Loans, involving an element of subsidy, have been widely employed to peg prices, to improve the marketing system, and to preserve and increase farm ownership.

This program has undoubtedly resulted in numerous benefits for agriculture. While farmers have not attained parity price and parity

[34] *Ibid.*, p. 70.

income, cash farm income has been raised to approximately double the 1932 low, and the farmer's share in the national income has also been increased. Debt burdens have been substantially lightened. The marketing system has been improved. Improved land use and increased farm efficiency have been promoted.

But the problem of finding adequate commercial outlets for the existing productive capacity of American agriculture remains unsolved. If foreign outlets continue to evaporate, if there is no corresponding growth in the domestic demand for farm commodities to take up the slack, and if new technical developments in farming continue to be introduced, it will become increasingly apparent that fewer farmers, cultivating fewer acres, will probably be able to supply the market available to American producers. If that be the direction of development, the question is raised whether agricultural policy ought not to be directed toward shifting surplus and marginal farmers into other occupations, instead of forcing general curtailment on all farmers now engaged in agriculture and supporting them by a generalized and expensive subsidy policy. The feasibility of such an alternative would seem to depend upon whether industry can absorb so-called surplus farmers. If siphoning surplus farmers into other "occupations" means adding them to urban relief rolls where they would have to be entirely supported by the community, there is much to be said for giving aid on the farm where it can be supplemented by subsistence farming.

It may well be that there are other alternatives besides those which have been posed above. Revival of exports through trade agreements or barter arrangements, discovery of new uses for agricultural products, and expansion of domestic demand as a result of industrial recovery or through special programs designed to increase the consumption of low income groups might all aid in absorbing agricultural surpluses. Downward tariff adjustments on manufactured goods, or a vigorous antitrust policy designed to reduce prices on products that farmers buy, would help to provide parity prices on farm products by making the relationship between farm and nonfarm prices more satisfactory to the agricultural population. Developments in all these directions would open up new vistas for agriculture and relieve the pressure for government subsidies. But, pending such developments, it seems likely that the pressure of farmers and their spokesmen for what they deem to be a fair share of the national income will continue to be a force in American politics with which other groups in the community will have to make their terms.

Chapter Six. PROMOTION OF THE INTERESTS OF LABOR

The complex of relationships between government and labor is of vital importance in the modern state. Numerically the largest group in the community, workingmen and women, when organized for the promotion of their interests, can bring powerful pressures to bear on the democratic machinery of policy formation. Organized labor has become an increasingly significant factor in American politics; the competition of politicians for its support has produced an increasing volume of legislative and administrative measures designed to benefit the "labor interest."

Since the working class includes virtually the whole lower income ranges of the population, it is difficult to distinguish between measures seeking to improve the relative position of this entire group and the specific promotion of labor interests. Progressive taxation of incomes and inheritance, free public education, recreational facilities, and promotion of low-cost housing have all been warmly supported by labor. Compulsory education may favor the worker not only by increasing his children's opportunities, but also by reducing the direct competition of low-paid child labor. Labor support was also given to the free land policy of the federal government during the second half of the nineteenth century; likewise, restrictions on immigration enlisted labor approval. Regulation of "sick" industries, as in the case of the Bituminous Coal Conservation Acts of 1935 and 1937, may be sponsored primarily by labor groups. Social security and relief legislation, finally, are designed to relieve the worker of some share of the risks of the modern industrial order. While all of these policies and meas-

ures can be related to the general topic of this chapter, the discussion which follows will focus specifically on two central activities of government in relation to labor: (1) protective legislation and (2) the attitude of government toward labor organization and industrial disputes.

Protective legislation directly aids the economically weakest workers by setting minimum standards. It has followed a fairly uniform pattern in all industrial nations. Generally beginning with maximum hours for women and children, requirement of safety apparatus in hazardous occupations, factory inspection, and provision for workmen's compensation for accidents, it has in most cases spread to include a limited working week for all and minimum wages at least for women and children. While labor pressures have greatly stimulated this legislative trend, particularly in shortening the work week, its earliest manifestations were occasioned by a general humanitarian sentiment, reflected in statutes even before workers had been given the vote.

Even more significant is the attitude of government toward labor organization and industrial disputes. Organization is a prerequisite of success for laborers, both in their direct bargaining with employers and in their efforts to achieve *as laborers* a heightened social status. Increased organization and improved legal position are, to some extent, mutually interdependent. For effective political pressure depends on organization, while the government attitude, both in law and in discretionary administration, is at all times a vital factor in aiding or hindering such organization. Over the past century and a half, American public policy has been transformed slowly, from outright condemnation of labor organizations as criminal conspiracies, regardless of their purposes, to relaxation of restraints, and finally to positive encouragement of their operations.

1. Protective Labor Legislation

Protective labor legislation regulates or limits the conditions of employment in favor of the employee. It is premised upon the assumption that unequal bargaining power between the parties to a labor contract, if uncorrected, produces results which may be unjust or socially undesirable. Although the volume of such legislation upon the state and federal statute books is now enormous, the United States has in this respect lagged behind the industrial nations of

Europe and the British dominions. The movement has until recently received only lukewarm support from organized labor, which has preferred to improve its bargaining position through independent collective action rather than legislation. It has also faced high, and at times insurmountable, hurdles in the form of constitutional limitations and the complexities of our federal political structure.

Statutes of this sort necessarily modify that "freedom of contract" which the courts have held to be included within the constitutional guarantees of liberty in the Fifth and Fourteenth Amendments. They may, therefore, be sustained only when in accordance with due process of law. Over the last half century, dozens of labor statutes have fallen before this obstacle. So broad and uncertain has been the requirement of "due process" that any infringement of contractual liberty failed to satisfy it if the legislation appeared to the courts to be "arbitrary, unreasonable, or capricious." These tests depended, in turn, on social and economic attitudes rather than legal training. It was in the field of labor protection, especially, that the familiar classification of judges into "conservatives" and "liberals" was most sharply manifested and the fate of legislation often decided by a closely divided Supreme Court.

Statutes designed to protect separate classes of workers may also be attacked under the "equal protection" clause of the Fourteenth Amendment. The state must show the reasonableness of any classification setting aside particular groups for special treatment. While the law has always recognized children as a class apart, which the state might protect as its "wards," recognition for women's labor legislation was won only after a long uphill battle. Protection for miners, seamen, railroad workers, and other similar groups had also to meet this constitutional test.

Dispersion of legislative authority among the forty-eight states has also seriously hampered the enactment of protective labor legislation. Until the recently expanded interpretation of the commerce clause by the Supreme Court, federal authority in regard to labor was confined to interstate and foreign transportation, government employees, and the District of Columbia. A degree of indirect control might also be exercised over working conditions on public contracts. The taxing power, while successfully employed in order to outlaw the manufacture of white phosphorus matches, could not be extended to general regulation of labor conditions through differential levies. The bulk of labor legislation, therefore, was in the hands of the states,

utilizing their general "police powers." As long as most economic enterprise was localized, and industry confined to a few states, this situation raised no serious difficulties. But, with the development of rapid transportation and large-scale production, economic life became regional, national, and even international. A state legislature had good reason to hesitate in raising its labor standards when its manufacturers were in direct competition with rivals in low-standard states. Industries have on occasion been relocated in order to take advantage of more lenient legislation, particularly in periods of ruthless competition occasioned by general depression. An effective minimum plane of competition could be set only by federal action, but constitutional interpretation made the federal government impotent until 1937.

CHILD LABOR

Limitations on child labor are the oldest examples of protective legislation. The movement to protect the young wage earner from exploitation stems from the English Health and Morals of Apprentices Act of 1802, which forbade night work and limited the working day to twelve hours for apprentices in textile mills. In this country, where the factory system developed several decades later than in England, the earliest corresponding statute was passed by Massachusetts in 1842. It prescribed a ten-hour daily maximum for children under twelve. Shortly after the Civil War the same state prohibited child labor under the age of ten in manufacturing, extended the ten-hour law to children up to fifteen, and established a system of factory inspection without which labor legislation is ineffective. During the remainder of the century most states adopted child labor laws of some variety, generally coupled with compulsory education. Except for those dealing with the very young, they did not actually prohibit child labor, even in the more hazardous or injurious occupations, until the decade preceding the war. Thus, the proportion of ten to fifteen-year-old children gainfully employed rose steadily until 1910.

In the "progressive era" of the early twentieth century almost every state adopted or extended child labor legislation. The outlines of the modern type of statute then took shape. Gradual extension of state laws continued after the first World War and was greatly accelerated in the early years of the New Deal. The most far-reaching laws now forbid factory or store work by children under sixteen and mining and other particularly hazardous occupations by those under eighteen.

They have also generally restricted work by children under sixteen to a limited number of out-of-school hours. Night work is generally forbidden, and in some states minimum wage and maximum hour laws apply to women and children alike. The bulk of the states fall very short of the leaders both in age and hour provisions and in machinery of enforcement. While street selling is regulated in some cases, agricultural child labor is almost wholly untouched, save by relatively ineffective provisions for school attendance.

No sooner had a number of states imposed serious checks on child labor than the limitations of action by single states became evident. Agitation for supplementary federal legislation led to platform planks on the subject by both major parties in 1916 and the passage in that year of the Owen-Keating Act. This law forbade the interstate transportation of goods on which children under fourteen had worked, or on which children of fourteen to sixteen had worked over eight hours a day. The commerce clause was thought to justify the constitutionality of this act, on the model of the recently sustained Food and Drug Law and the Mann Act which forbade the interstate transportation of women for immoral purposes. In 1918, however, after only a few months of successful administration, the act was struck down by the Supreme Court in a five to four decision.[1] The majority opinion distinguished between the regulation of commerce in goods which were harmful per se and its regulation in order to modify the conditions of production, declaring the latter beyond the scope of federal power. A second attempt to deal with the problem was at once made by Congress under the taxing power, modeled on the successful elimination by this means of white phosphorus matches and oleomargarine colored to resemble butter. This act also failed to meet judicial approval, a six to one majority of the Supreme Court declaring it to be a penal regulatory measure dealing with production under the guise of taxation, rather than a real tax.[2]

In 1924, therefore, a constitutional amendment was submitted by Congress to the states, giving Congress the power "to limit, regulate,

[1] *Hammer* v. *Dagenhart,* 247 U.S. 251 (1918). This case was overruled in 1941 in *U.S.* v. *Darby Lumber Company,* 9 U.S. Law Week 4170. Justice Stone spoke for a unanimous court as follows: "The conclusion is inescapable that *Hammer* v. *Dagenhart* was a departure from the principles which have prevailed in the interpretation of the commerce clause both before and since the decision and that such vitality, as a precedent, as it then had has long since been exhausted. It should be overruled."

[2] *Bailey* v. *Drexel Furniture Co.,* 259 U.S. 20 (1922).

and prohibit the labor of persons under eighteen years of age." Under the leadership of Southern textile operators, the American Farm Bureau Federation, and the National Association of Manufacturers, a vigorous and successful campaign was organized against ratification. By 1933 only six states had given their approval. In the more favorable atmosphere of the New Deal period, twenty-two more states ratified the amendment and efforts continued to secure the approval of the eight further states required for adoption.[3] Meanwhile, federal action was again taken in part of the field under the National Industrial Recovery Act of 1933 and the Fair Labor Standards Act of 1938. These measures will be considered below in connection with other phases of protective legislation under the Roosevelt administration.

HOURS OF WORK

During the past century the nonagricultural worker's average week has been reduced from seventy to slightly over forty hours. The reduction has been gradual and at all times with marked variations among different occupations. In steel, for example, the twelve-hour day persisted until 1923. Organized labor has demanded steady shortening of hours with a persistence second only to the pressure for increased wages. It has won adherents from other groups in the community through its pleas for adequate leisure in which to develop the attributes of "good citizenship," through evidence as to the deterioration of physical and mental health from excessive hours, and more recently by relating long working hours to unemployment. Whereas in other countries such demands, for the most part, were met many decades ago through government action, in the United States hours legislation has until recently been applied only to children, women, and special occupations. For this contrast the attitude of the A.F. of L. toward protective legislation is partly responsible. Until 1933 it steadfastly refused to endorse general hours laws for adult males. Constitutional limitations, only slowly removed by judicial interpretation, were another obstacle. The first comprehensive regulation of working hours dates from the NIRA and the federal Wage and Hour Law of 1938.

Limitation of working hours for children dates back to the Massachusetts statute of 1842, for women to a law passed in New Hamp-

[3] The Supreme Court has recently held the amendment still open for ratification, with two justices dissenting. *Chandler* v. *Wise*, 307 U.S. 474 (1939).

shire in 1847. The early restrictions on women's hours were ineffective, generally allowing employer and employee to "contract out" of them by mutual agreement.[4] Effective limitation began in the seventies, but was at once threatened by differences of opinion among state courts as to its constitutionality. Only in 1908 was the issue finally resolved in its favor.[5] A great number of statutes followed during the early years of the Wilson administration, producing a flood tide of labor legislation unparalleled until the New Deal. By 1939 all but four states had enacted some type of limitation, Pennsylvania setting a forty-four-hour week (applying also to men), and twenty other states, as well as the District of Columbia, providing a forty-eight-hour maximum. Some states merely prohibited night work, while in all cases the exempted classes were numerous. Domestic servants were unprotected except in the state of Washington. Agricultural labor was rarely affected. Here, again, the lack of uniformity hindered legislation and produced pressures for federal action. Some of the recent statutes have made their operation contingent upon the adoption of similar standards by specified contiguous states or by Congress.

Hours laws for men began with government employees and gradually broadened out into widening circles of public concern. Civil servants have always been particularly favored in this respect. Navy yard workers were given the ten-hour day in 1840. The eight-hour day was adopted in principle for government employees and workers on public contracts in 1869, although its effectiveness was limited until 1912. Most states have followed the federal example. Hours of workers engaged in transportation are also generally limited by law, in order to protect travelers, freight, and the employees themselves from the unusual risks incident to fatigue. A federal act of 1907 limited continuous hours by any employee on railroad operation to sixteen, to be followed by at least ten hours of rest. Similar standards are almost universally required by the states. In 1916, under threat of an imminent railroad strike and at the urgent demand of President Wilson, Congress within four days passed the Adamson Act, giving

[4] Thus, the New Hampshire ten-hour law applied only in the absence of "an express contract requiring greater time."

[5] Cf. *Ritchie* v. *People*, 155 Ill. 98 (1895); *Muller* v. *Oregon*, 208 U.S. 412 (1908). The latter case was the occasion of L. D. Brandeis's celebrated brief on the ill effects of long hours for women.

trainmen the "basic" eight-hour day without wage reductions.[6] Overtime payment at "time and one half" was not adopted for railroad workers until 1919. Seamen's hours have also been legally limited since 1913, and in 1936 they were lowered to eight a day both at sea and in harbor.

Hours regulation in other occupations has always faced the contingent threat of judicial invalidation. If particular industries are set aside for special legislation, it must be shown that they offer unusual hazards to health. Although the Supreme Court had upheld both an eight-hour law for miners in Utah and Oregon's ten-hour limit for factory employment in general,[7] the constitutionality of more far-reaching experiments such as the Pennsylvania law of 1937, which prescribed an eight-hour day and forty-four-hour week for all workers, men and women, except agricultural laborers, domestic servants, executives, and professionals, remained in some doubt until 1941. In that year the Supreme Court, in upholding the constitutionality of the federal Wage and Hour Law, dissolved such doubts as remained. "Since our decision in *West Coast Hotel Company* v. *Parrish*," said Justice Stone for a united Court, "it is no longer open to question that the fixing of a minimum wage is within the legislative power and that the bare fact of its exercise is not a denial of due process under the Fifth more than under the Fourteenth Amendment. Nor is it any longer open to question that it is within the legislative power to fix maximum hours." [8]

WAGES

Although theoretically no more "central" than the amount of time worked by an employee, the wage received has always been viewed as the "heart" of the labor contract. General wage regulation has been as foreign to the traditions of our economic order as general price regulation. Even minimum wage legislation (which was first enacted in New Zealand in 1894, spread rapidly to the Australian states, to Great Britain in 1909, France in 1915, and other industrialized Euro-

[6] Since this law did not forbid overtime work, or even require higher rate of pay for overtime, it was, in effect, a wage-regulating rather than an hours law. On this basis its constitutionality was very doubtful, but an argument along these lines was rejected by the Supreme Court. *Wilson* v. *New*, 243 U.S. 332 (1917).

[7] *Holden* v. *Hardy*, 169 U.S. 366 (1898); *Bunting* v. *Oregon*, 243 U.S. 426 (1917).

[8] *United States* v. *Darby Lumber Co.*, 61 S.Ct. 451 (1941).

pean countries after the first World War) was of little consequence in America until the New Deal. Minimum wages are generally applied first to women, children, and other "sweatshop" workers, then to the unskilled. The unimportance of these groups in the organized labor movement until recent years has given labor leaders little incentive to promote such government protection. The attitude of the C.I.O. marks a significant shift in this respect. At the same time, the Supreme Court let down the constitutional barriers to women's and children's minimum-wage laws only in 1937.

A considerable volume of state legislation deals with incidental features of wage payments. Mechanic's lien laws give workers a first claim on the assets of an enterprise for unpaid wages. Some states afford free legal assistance in collecting wages due. Various regulations prescribe the place and frequency of payment, forbid the use of "company scrip," and require dismissal payments.

America's slowness to adopt minimum wage legislation was not due to the absence of conditions corresponding to those abroad. Successive investigations over several decades have shown that wages paid in certain occupations to unprotected, unorganized, and economically weak workers, particularly women and children, are inadequate to maintain a decent and healthful standard of living no matter how barely defined. The apparent success of the Australasian and British experiments, combined with a number of striking revelations of sweatshop conditions and the generally powerful humanitarian sentiment of the time, brought into being a movement for American laws of this sort which achieved considerable momentum after 1910. The laws were confined to women and children, both because of constitutional doubts as to more general regulation and because of the oft-expressed fears of the trade-unions that minimum wages for men would tend to become a maximum.

In 1912, Massachusetts enacted a mild measure, the only sanction for which was provision for publication of the names of firms paying less than the minima recommended by an investigating commission. Other states followed with more effective statutes, either setting a stated minimum in the law itself or delegating authority to wage boards to establish minima appropriate to particular industries, and providing penalties for nonobservance. In 1917, the Supreme Court divided equally on the constitutionality of Oregon's law, Justice Brandeis not participating, and the statute stood.[9] By 1925 fifteen

[9] *Stettler* v. *O'Hara,* 243 U.S. 629 (memorandum decision without opinion).

states and the District of Columbia had enacted minimum wage laws of greater or lesser extent.

A shift in Court membership suddenly brought the movement to a halt. To the surprise of many lawyers, a five to four decision invalidated the District of Columbia statute.[10] The majority opinion is a classic statement of the narrow view of police powers under the due process clause. Minimum wage fixing remained in abeyance until the depression years of the thirties.

The breakdown of general wage standards after 1931, together with a widespread increase in industrial homework and recrudescence of the worst evils of sweatshop operation, stimulated renewed efforts to set a "floor" under wages. The most striking results were embodied in codes under the NIRA, considered below. In addition, it was sought to evade the obstacles of the *Adkins* decision by more carefully drawn state statutes. Certain phrases in Justice Sutherland's opinion in that case had suggested the possible constitutionality of a law setting the minimum wage at "reasonable value of services rendered" rather than at a minimum living standard without regard to the work performed. The attempt was unavailing; in 1936 the Court's majority of five saw no sufficient distinction between the two types of statute.[11] In 1937, however, the shift of a single judge altered the entire outlook. The new majority frankly overruled the *Adkins* case;[12] by 1941 the constitutionality of minimum wage legislation appeared no longer to be open to question.[13] In 1939 a total of twenty-five states had minimum wage legislation in force. Meanwhile, the federal law of 1938, to be dealt with below, marked the apparent beginning of a permanent, nation-wide policy in this regard.

WORKMEN'S COMPENSATION

In recent years, the economic risks which face the worker through technological or general cyclical unemployment have come into great prominence. Parallel with them and long antedating them in public attention, although far less dramatic, are the risks of illness and accident. The latter grew increasingly severe during the nineteenth cen-

[10] *Adkins* v. *Children's Hospital*, 261 U.S. 525 (1923). Subsequent decisions invalidated the Arizona and Arkansas laws. *Murphy* v. *Sardell*, 269 U.S. 530 (1925); *Donham* v. *West-Nelson Manufacturing Company*, 273 U.S. 657 (1927).

[11] *Morehead* v. *New York ex rel. Tipaldo*, 298 U.S. 587.

[12] *West Coast Hotel Co.* v. *Parrish*, 300 U.S. 379.

[13] See quotation above, p. 141, from *U.S.* v. *Darby Lumber Co.* (1941).

tury, as powerful and oftentimes dangerous machinery became a regular adjunct of industry. Direct safety legislation was stimulated by particularly severe accidents, especially in mining and transportation, and has developed into an important body of law, state and federal. No preventive measures could be universally successful, however, and society was faced with the problem of support for the temporarily or permanently disabled worker and his dependents. Common-law rules developed in the first half of the nineteenth century made it extremely difficult for an injured employee to recover damages from his employer, even assuming that he could afford to set in motion the machinery of justice. The burden of inherent occupational risk was held to lie with the worker and to be reflected in his wages. Under the doctrine of "assumption of risk," employers escaped responsibility even for abnormal hazards if it could be shown that the worker was aware of them when taking the job. Again, while employers were required to exercise reasonable care in preventing accidents, the doctrine of "contributory negligence" excused them of all liability if the worker were in any degree responsible for a particular accident, no matter how great the employer's negligence. Nor was an employer responsible for accidents due to the negligence of a fellow worker. During the eighties, various states abrogated these harsh rules, shifting liability to the employer. Even with this aid, the economically weak worker often found it difficult to recover damages through the ordinary processes of the courts.

Meanwhile, other nations began to experiment with compulsory accident insurance. Germany, in 1884, and Great Britain, in 1897, began the movement which has since spread to every industrialized country and become the most highly developed branch of protective labor legislation in the United States. Compulsory workmen's compensation laws substitute payment on a fixed scale for the doubtful chance of large jury damages in a court suit. Procedure is simplified and recovery hastened through the use of administrative commissions for the establishment of valid claims. Insurance funds for payments are built up out of employers' premiums, usually in private insurance companies but in some instances directly operated by the states. Premium reductions are generally given for a good accident record. In the majority of the forty-six states with workmen's compensation laws, acceptance of the machinery is optional with the employer, but his alternative is the possibility of a large adverse judgment under an employers' liability law depriving him of the common-law defenses.

The principle of workmen's compensation is now generally accepted by all interested groups. It is recognized as a strong incentive to voluntary preventive measures. When first agitated in the state legislatures around the turn of the century, however, it was hotly contested by employers. In labor circles, the influential railway brotherhoods long preferred the occasional recovery of enormous damages. As successive legislatures adopted compensation the battle was transferred to the courts. Its constitutionality was successfully challenged in a number of states, chiefly on the ground that it required liability when an employer was not at fault and interfered with freedom of contract. In a series of Supreme Court decisions in 1915 and 1917, however, its validity was established beyond doubt.[14] "The subject-matter in respect of which freedom of contract is restricted," said the Court, "is a matter of compensation for human life or limb lost or disability incurred in the course of hazardous employment and the public has a direct interest in this as affecting the common welfare."

Contemporary controversy over compensation laws turns about issues of coverage, rates of payment, types of insurance funds, and the proper definition of "accident." In recent years special attention has been given to the inclusion of occupational diseases. Twenty-three states now require their compensation to some extent, but with great variations in the range of diseases covered. Closely allied with such measures is the possibility of general health insurance, now provided by law in every industrialized nation other than the United States. Along with the cognate topics of unemployment and old age insurance, we shall deal with American developments in this field in Chapter 21.

ADMINISTRATION OF PROTECTIVE LEGISLATION

The very inequality of bargaining power between employer and employee, which is the root cause of protective legislation, also creates a need for special administrative devices if that legislation is to be effective. If the enforcement of laws prescribing hours, wages, working conditions, and limitations on child labor is left to civil court action by injured employees, or even to criminal action begun on their complaint, experience shows that even the best-drawn statutes will go unheeded. Successful labor legislation demands enactment of stand-

[14] *Jeffrey Manufacturing Co.* v. *Blagg,* 235 U.S. 571 (1915); *New York Central Railroad Co.* v. *White,* 243 U.S. 188 (1917); *Hawkins* v. *Bleakly,* 243 U.S. 210 (1917); *Mountain Timber Co.* v. *Washington,* 243 U.S. 219 (1917).

ards in general terms, leaving to administrative agencies the task of filling in details to fit the infinite variety of industrial conditions. Even with legislation dealing with the rights and duties of employer and employee in their mutual relations, like employers' liability, workmen's compensation, and, more recently, labor relations acts, enforcement has been found most successful when in the hands of administrative tribunals, with suitable channels of appeal to the courts on questions of law. Hence the development of state corps of factory inspectors, wage and hour commissions, and similar agencies. In the most advanced states the bulk of labor administration is concentrated in an integrated department, the chief of which is a high official in close contact with the governor. The disparities in administrative standards among the states, however, are even greater than those in the statutory requirements themselves.[15] As a result, protective legislation in this country in practice falls even shorter of foreign standards than a mere comparison of statutory texts would indicate.

Apart from administrative functions proper, organized labor has long demanded continuing agencies within the government to watch over the general interests of labor and to represent its viewpoint in broad policy formation. The most prominent response to this demand is the United States Department of Labor, paralleled to some extent by corresponding units in the states. The federal department is the youngest of the cabinet agencies, reaching that status only in consequence of continuous pressure from the A.F. of L. Its predecessors, a bureau within the Department of the Interior (1884), an independent but noncabinet department (1888), and the Department of Commerce and Labor (1903), were all viewed by the Federation as incapable of giving labor that independent representation in the highest councils of the nation which it claimed as labor's due. In 1913, just before his retirement, President Taft approved a measure establishing the present department. It was instructed by the statute "to foster, promote, and develop the welfare of the wage earners of the United States, to improve their working conditions, and to advance their opportunities for profitable employment." The Secretary of Labor was also given special authority to mediate industrial disputes.

While the Federation thus secured a victory, and Secretaries of

[15] Since 1934 the Division of Labor Standards of the Department of Labor has sponsored an annual conference on labor legislation to which representatives of state labor departments, organized labor, and independent labor experts are invited. The Division endeavors to stimulate improvements in administrative standards.

Labor were, until 1929, regularly selected from among its nominees, the new department from birth was a governmental stepchild. Its skeleton of organization, comprising the Bureaus of Labor Statistics, Immigration, and Naturalization, the Children's Bureau, and after 1920 the Women's Bureau, was adequate, but tiny appropriations and weak personnel reduced it to a poor counterpart of its elder brothers in agriculture and commerce. As late as 1932, when Commerce Department expenditures were almost $50,000,000 and those of the Agriculture Department (excluding the Bureau of Public Roads) reached $124,000,000, the Labor Department expended a mere $14,700,000. Of this figure, immigration and naturalization absorbed $11,600,000, leaving only $3,100,000 for promotional and informational service proper. Here, again, the New Deal produced a radical transformation. By 1940 nonemergency expenditures had risen to $28,300,000, of which $10,100,000 went to immigration and naturalization, leaving $18,200,000 for other services. This increase of almost 500 per cent in nonemergency expenditures exclusive of immigration and naturalization testified to the heightened importance of labor in the national political scene. The Women's and Children's Bureaus in particular, together with the newly created Division of Labor Standards and the United States Employment Service, have thus been enabled to play a major role in stimulating the increased interest in the new protective legislation which has characterized recent years. With the development of a positive labor policy, moreover, the Department has come to serve as a significant pressure group on behalf of unorganized workers, who are unrepresented by powerful independent lobbies. It aids them not through the promise of direct political support, but through the dissemination of information and the co-ordination of the activities of social welfare and other groups, which depend upon the Department for guidance.

2. Trade-unions, Industrial Disputes, and the Law

The major instrument of protective labor legislation is, of course, the legislature itself, with administrative agencies a close second. By contrast, the reciprocal rights and duties of employers and employees which go to make up the law of industrial relations have, until recent years, been hammered out almost exclusively by the courts. In addition, where disagreements lead to strikes or lockouts, the attitude of the executive—local, state, or federal—is often decisive. In this area,

before 1932, legislative guidance to the other branches of government was scanty. Of the few statutes enacted, some were reshaped in the mold of judge-made law in the course of judicial interpretation, and others were invalidated as incompatible with the judges' views of rights sanctified by the due process clauses. Thus, the framework of law within which labor relations were conducted was to be found primarily in judicial records and in the impact of executive authority on industrial disputes in action.

INDUSTRIAL RELATIONS AT COMMON LAW

While the phraseology of judge-made law in dealing with industrial relations is often interspersed with ancient common-law terms, the bulk of its substance dates from the second half of the nineteenth century when both corporate business organization and trade-unionism first made their appearance in modern form. Following a long series of English precedents, the American courts had at one time looked upon all labor organizations as unlawful per se, indictable as criminal conspiracies regardless of their objectives or methods. This stern doctrine was, with few exceptions, abandoned after the celebrated decision of the Supreme Judicial Court of Massachusetts in *Commonwealth* v. *Hunt* (1842),[16] which found no objection to combined action seeking lawful ends by lawful means. Subsequent case law sought to determine an area of legitimate union objects and an area of legitimate methods for their pursuit. Where the ends were forbidden, even methods otherwise lawful might be prevented. Injured employers could get redress through damage suits or injunctions to forestall illegal action. In certain cases, the executive might also bring criminal charges against union officers and members.

Collective bargaining to improve standards of wages, hours, and working conditions was universally recognized as legitimate. Trade agreements, the end result of this process, were given judicial sanction, and are now generally treated as legally enforceable, if not precisely contractual relationships. Where a union sought the closed shop (i. e., employment only of members), however, or the union-preference shop (hiring of members in preference to nonmembers as long as the former are available), the courts were more hesitant to approve its activities. On this point the law still varies from jurisdiction to jurisdiction. Some states, like New York, permit strikes for the closed

[16] 4 Metcalf 111.

shop unless tending to create a local monopoly; in Massachusetts and elsewhere such strikes are unlawful, although a closed shop agreement is not in itself unenforceable.

Reinforced by the provisions of the Thirteenth Amendment forbidding involuntary servitude, the common law gave to individual workers the unqualified right to quit work, correlative to the employers' right to discharge employees for any or no reason. The strike, or concerted withdrawal from work, stands on a different footing. It may conflict with employers' rights equally sacred to the law—their right to do business free from coercion or intimidation and to receive protection from public authority both for their physical property and their legitimate expectations of free access to supplies of labor and raw materials and to consumers. Labor's use of the boycott as a weapon raises the same issues. The courts concede the inequality in bargaining power between individual workers and their employer, who is often a large corporate aggregate treated by the law as a single person. Where the line shall be drawn between these conflicting rights, however, is a matter of social policy rather than ancient and definitive legal precedent. In formulating this policy court decisions, as modified by statute, shape the course of industrial relations and often determine the success or failure of efforts at labor organization.

In addition to limitations on strikes for union recognition and the closed shop, the conduct of strikers is surrounded by rigid restrictions. In their efforts to persuade "loyal" workers to lay down their tools, and to prevent strikebreakers or "scabs" from entering a plant, they may not use violence or intimidation. Before 1921, even "peaceful picketing" was forbidden by some courts, while others considered that expression a contradiction in terms. In that year the Supreme Court found the provisions of the Clayton Act [17] of 1914 forbidding injunctions against peaceful persuasion to be "merely declaratory of what was the best practice always." It approved the placing of a single picket at each factory gate, limited in his activities to "communication or persuasion," but condemned mass picketing, "persistence, importunity, following and dogging." [18] And in the same year an Arizona statute, construed by the state courts to deny equitable relief against the "moral intimidation" of mass picketing, was declared by the Supreme Court to be contrary to the guarantee in the Fourteenth

[17] Cf. below, p. 154.

[18] *American Steel Foundries* v. *Tri-City Central Trades Council*, 257 U.S. 184 (1921).

Amendment of the equal protection of the laws and, therefore, unconstitutional.[19]

Labor's second chief weapon in industrial disputes, alternative or supplementary to the strike, is the boycott. Variously defined, it includes what is sometimes called a "consumers' boycott" (that is, concerted refusal to purchase boycotted materials), as well as what is called a "workers' boycott" (that is, refusal to work on boycotted materials). The latter form may involve a threat to strike or an actual strike. Such strikes are sometimes called "sympathetic strikes" because they are designed to aid fellow unionists and effect unionization of the businesses supplying the products against which the strikes are called. Until recent statutory modifications, the trend of the law was strongly against such workers' boycotts. In most instances the positive interest of boycotters or sympathetic strikers in organization elsewhere was held too uncertain and indirect to justify the injury caused. Consumers' boycotts are commonly classified into "primary" and "secondary" types. The former, involving merely concerted refusal to patronize an employer by the workers directly concerned in a dispute, is uniformly sustained. On the other hand, its effectiveness is generally inconsequential. "Secondary boycotts," which alone promise positive results, extend to "neutral" parties like dealers and transportation agents of the employer directly concerned in the dispute, and include coercive pressure of any sort upon his customers. The term, however, is by no means precisely defined and its use has often beclouded the law. Here the courts are prone to forbid the action as an unwarranted interference with the right to do business. In this area, again, the law has failed to evolve a precise line of demarcation. The most important boycott cases, arising under the antitrust laws, will be treated below.

On the employers' side, also, certain rights and duties have been tested by court action over the last half century. Employers are free to join forces in dealing with labor, either for negotiation or for collective resistance to unionization or union demands. A number of trade associations and business organizations, including the National Association of Manufacturers, have devoted themselves largely to work of this nature. Individual employers may close their plants in a "lockout" at any time and for any reason. They may demand protection against violence, and supply it themselves in the form of company

[19] *Truax* v. *Corrigan,* 257 U.S. 312 (1921). Justices Holmes, Brandeis, and Pitney dissented.

police and armed guards, subject only to very mild statutory restrictions. Access to the plant must be maintained by public authority for either "loyal" workers or professional strikebreakers. Before the advent of the New Deal, the law permitted discrimination against union members at the employer's unlimited discretion. Company unionism, a most effective weapon against independent labor organization during the postwar decade, might be promoted by any means short of physical violence, including economic duress.

Contractual freedom extended to one form of agreement peculiarly distasteful to organized labor. In signing a "yellow-dog" contract, a worker agreed not to join a union or participate in union activities. Since an employer could discharge men at will in any case, these provisions were at first of little consequence. In 1917, however, a six to three decision of the Supreme Court sustained an injunction against union officials forbidding them to attempt the organization of workers bound by such contracts.[20] Moreover, a divided Court had previously invalidated both federal and state statutes outlawing this practice, as well as discrimination against union members, as contrary to the due process clause.[21] Thus, the yellow-dog contract became a powerful antiunion weapon.

Apart from legal rights, employers had certain marked advantages accruing from their general position in the social framework. Few in number, they could maintain in secrecy illegal activities like concerted blacklisting of union members, while the corresponding workers' boycott was perforce publicly known. In most areas they enjoyed the sympathy of middle-class elements and of the local executive and judiciary. With rare exceptions, the use of state militia and federal troops, or the declaration of martial law during strikes, was the prelude to defeat or destruction of the union by the combined forces of employers and the "public." A well-disposed police force, or company guards temporarily enlisted as deputy sheriffs, often arrested union leaders on petty charges, holding them for the duration of the strike and releasing them only when their cause was already hopeless. In company towns private police might deal with union organizers

[20] *Hitchman Coal and Coke Co.* v. *Mitchell*, 245 U.S. 229 (1917).

[21] *Adair* v. *United States*, 208 U.S. 161 (1908); *Coppage* v. *Kansas*, 236 U.S. 1 (1915). The former case dealt with portions of the Erdman Act of 1898, applying to railway labor. Although these cases have never been formally overruled, the tenor of recent decisions in this field plainly indicates a change of attitude on the part of the Supreme Court.

as trespassers. Superior economic resources, coupled with the natural sympathies of newspaper owners and the leverage of advertising control, also tended to maintain for employers a favorable attitude at the sources of public opinion formation, often a decisive factor in closely contested strikes.

In seeking to establish their legal rights against unions, employers have been somewhat hampered by the common-law rule that unions, as unincorporated associations, might not be sued in their own name. Most states retain this rule, although it was reversed for the federal jurisdiction by the Supreme Court decision in 1922 in the first *Coronado Coal* case,[22] which permitted recovery against a union in its quasi-corporate capacity, out of union funds, provided that official responsibility could be shown. Elsewhere the action must lie against individual officers and members, whose financial resources are often very limited. Employers have consequently sought the compulsory incorporation of trade-unions. Labor vigorously opposes the suggestion as a subterfuge to permit additional harassing of unions in the courts, and the movement has made little headway.

Two factors in the complex of American law surrounding industrial relations, which played a particularly significant role in hampering trade-union growth, deserve special treatment. They are the influence of the Sherman Antitrust Law and the use of the injunction in labor disputes.

LABOR AND THE ANTITRUST LAWS

The genesis of the Sherman Act of 1890 is reviewed at length in Chapter 13. Its inspiration lay in the apparent dangers of the large corporate consolidations and price-fixing combinations of the period. Nonetheless, its terms outlawed "every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations." Whether it was meant to include the activities of organized labor has been hotly disputed.[23] But a consistent series of judicial decisions established its applicability regardless of Congressional intent. It thus became, despite a long campaign for repeal or amendment, a serious obstacle to many efforts at unionization.

[22] *United Mine Workers* v. *Coronado Coal Co.*, 259 U.S. 344 (1922).

[23] For a statement of the position that the Act was intended to apply to labor, see A. T. Mason, *Organized Labor and the Law* (1925); for the opposing view see E. Berman, *Labor and the Sherman Act* (1930).

The Sherman Act first attracted widespread public attention as an instrument of public labor policy during the Pullman strike of 1894, although it had served as the basis for a labor injunction against striking draymen in New Orleans a year earlier. Olney, Cleveland's attorney general, was at first reluctant to apply to labor a statute for which he had little respect even as a weapon against industrial monopoly. The railroad strike, however, seemed to him to warrant drastic federal action on any legal foundation available. To this decision his background as a railroad counsel may have contributed. Sweeping injunctions were obtained, based partly on the Sherman Act, partly on power to restrain interference with the mails, partly on a putative power to forbid hindrances to interstate commerce in general. Eugene V. Debs and other leaders were jailed for contempt. While lower courts stressed the Sherman Act, the Supreme Court refused to commit itself on the applicability of the antitrust laws, resting its affirmance on broader grounds.[24]

The consequent uncertainty was resolved in 1908. An elaborate secondary boycott against Loewe & Co., hat manufacturers of Danbury, Connecticut, had been instituted by the United Hatters of America as part of a campaign for the closed shop. A damage suit against the union's officers and members was dismissed by the trial judge on the ground that interstate commerce was not directly affected by the boycott.[25] Appeal to the Supreme Court obtained a unanimous reversal. A superficially persuasive argument on Congressional intent by counsel for the company, poorly combated by the union, led to an unequivocal declaration including labor activities within the scope of the Sherman Act. While neither the company nor its boycotted retailers were themselves engaged in interstate commerce, the boycott was viewed as designed to prevent interstate transportation of Loewe's hats, and hence to fall within the Act.[26] A jury subsequently awarded $74,000 damages, which when trebled and added to interest and costs totaled $252,000. The case was finally settled in 1917 for $234,000, mostly supplied by the A.F. of L.

The decision in the Danbury Hatters' case was received by labor with dismay. Federation officials viewed it not merely as a miscarriage

[24] *United States* v. *Debs,* 64 Fed. 724 (1894); *In re Debs,* 158 U.S. 564 (1895).

[25] *Loewe* v. *Lawlor,* 148 Fed. 924 (1906).

[26] *Loewe* v. *Lawlor,* 208 U.S. 274 (1908). The applicability of the Sherman Act was re-emphasized three years later in an *obiter dictum* passage in Justice Lamar's opinion in *Gompers* v. *Bucks Stove and Range Co.,* 221 U.S. 418 (1911).

of justice through an unwarranted reading of the statute, as a serious financial blow, and as an obstacle to the use of an important weapon of industrial warfare, but also as a potential threat to the very existence of unions. They saw on the horizon the shadow of dissolution suits by hostile attorneys general. In retrospect these fears appear unfounded. The Supreme Court's definitive interpretation of the Sherman Act in 1911, introducing the "rule of reason" and common-law tests of illegality, precluded the outright destruction of organizations almost uniformly sanctioned at common law since 1842. Nevertheless, repeal or amendment of the Sherman Act, along with abolition of "government by injunction," became the cardinal legislative objectives of the A.F. of L. It supported Democratic candidates in 1908 and 1912, and claimed its reward from the Wilson administration. The latter responded with several labor provisions in the Clayton Act of 1914.

Congress showed no inclination toward wholly exempting labor activities from the ambit of the antitrust laws. It did eliminate the possibility of dissolution suits by the somewhat grandiose words of Section six:

> That the labor of a human being is not a commodity or article of commerce. Nothing contained in the antitrust laws shall be construed to forbid the existence and operation of labor, agricultural, or horticultural organizations, instituted for the purposes of mutual help, and not having capital stock or conducted for profit, or to forbid or restrain individual members of such organizations from *lawfully* carrying out the *legitimate* objects thereof; nor shall such organizations, or the members thereof, be held or construed to be illegal combinations or conspiracies in restraint of trade under the antitrust laws.[27] [Italics supplied.]

[27] In addition, Section twenty surrounded labor injunctions with the following restrictions:

"That no restraining order or injunction shall be granted by any court of the United States, or a judge or the judges thereof, in any case between an employer and employees, . . . or between persons employed and persons seeking employment, involving, or growing out of, a dispute concerning terms or conditions of employment, unless necessary to prevent irreparable injury to property, or to a property right, of the party making the application, for which injury there is no adequate remedy at law, and such property or property right must be described with particularity in the application, which must be in writing and sworn to by the applicant or by his agent or attorney.

"And no such restraining order or injunction shall prohibit any person or persons, whether singly or in concert, from terminating any relation of employment, or from ceasing to perform any work or labor, or from recommending, advising, or persuading others *by peaceful means so to do;* or from attending at any place where any such

Despite the fulsome praise accorded Section six by Gompers and other Federation officials, it is evident on its face that the words italicized above effectively robbed it of any meaning, beyond debarring dissolution suits. Section twenty, while of somewhat more consequence, was restricted in application through its narrow definitions of both parties and the substance of disputes. The procedural alterations were of some real benefit to labor, but on balance the Clayton Act took away more than it gave. For, by Section sixteen, injunctive relief might now be sought under the antitrust laws not only by the government but also by private parties. Such actions soon became more numerous than criminal prosecutions, damage suits, and government applications for labor injunctions combined.

In 1921 these limitations were unequivocally stated by the Supreme Court. As we have seen, it described the Clayton Act as "merely declaratory of what was the best practice always." Neither intimidation by pickets nor secondary boycotts were freed by its terms from injunctive restraint.[28] In consequence, the antitrust laws retained their effectiveness as obstacles to unionization. Attempts of the United Mine Workers to protect union standards against competition from Southern nonunion mines, by organizing the latter, were frustrated by a series of injunctions and a damage suit. In the second *Coronado* case the Supreme Court unanimously applied the Sherman Act to a coal strike, using language of major potential significance:

> The mere reduction in the supply of an article to be shipped in interstate commerce by the illegal or tortious prevention of its manufacture or pro-

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person or persons may *lawfully* be, for the purpose of peacefully obtaining or communicating information, or from *peacefully* persuading any person to work or to abstain from working; or from ceasing to patronize or employ any party to such dispute, or from recommending, advising, or persuading others *by peaceful and lawful* means so to do; or from paying or giving to, or withholding from, any person engaged in such dispute, any strike benefits or other *lawful* moneys or things of value; or from peaceably assembling *in a lawful manner,* and *for lawful purposes;* or from doing any act or thing which might *lawfully* be done in the absence of such dispute by any party thereto; nor shall any of the acts specified in this paragraph be considered or held to be violations of any law of the United States." [Italics supplied.]

Other sections limited the duration of temporary restraining orders, forbade preliminary injunctions without notice to the opposite party, required the posting of adequate bonds by applicants for injunctions, outlawed "blanket" injunctions, and permitted trial by jury for alleged criminal contempt committed outside the presence of the court.

[28] *American Steel Foundries* v. *Tri-City Central Trades Council,* 257 U.S. 184 (1921); *Duplex Printing Press Co.* v. *Deering,* 254 U.S. 443 (1921).

duction is ordinarily an indirect and remote obstruction to that commerce. But when the intent of those unlawfully preventing the manufacture or production is shown to be to restrain or control the supply entering and moving in interstate commerce, or the price of it in interstate markets, their action is a direct violation of the Antitrust Act.[29]

Its effect was reinforced in 1927 by a decision, seven to two, reversing two lower courts and enjoining the relatively weak Journeymen Stone Cutters' Association from refusing to handle stone cut by the leading nonunion Indiana limestone quarry.[30] Justices Brandeis and Holmes, dissenting, argued in vain that the rule of reason should distinguish this nonviolent defensive action of a weak union against a dominant employer from the elaborate coercive tactics, illegal in themselves, condemned in the *Duplex* case.

Since 1937, the commerce clause has been enormously expanded in the course of application of the National Labor Relations Act. However beneficial this process to organized labor, it carried with it the danger of parallel expansion of the antitrust laws. In 1939 a federal district court awarded the Apex Hosiery Company triple damages to the amount of $712,000 on the basis of a sitdown strike by the American Federation of Hosiery Workers, which was held to constitute a conspiracy in violation of the Sherman Antitrust Act. On appeal to the Circuit Court of Appeals, however, the decision was reversed and the Supreme Court upheld the reversal, Hughes, McReynolds, and Roberts dissenting. Justice Stone, speaking for the majority, held that although interstate commerce was affected, the strike did not violate the Sherman Act since it was not intended to have, and did not have, any substantial effect on commercial competition in the market.[31] In offering the test of market control as a prerequisite for a finding that union activity violated the Sherman Act, the Supreme Court, in effect, shifted the ground of its earlier decisions and opened the way to the application of a new "rule of reason" to labor which would permit restraints of trade when incidental to otherwise legitimate organizational ends.

The policy of the Antitrust Division of the Department of Justice has recently been officially summarized by Assistant Attorney General Arnold as follows:

[29] *Coronado Coal Co.* v. *United Mine Workers of America,* 268 U.S. 295 (1925).

[30] *Bedford Cut Stone Co.* v. *Journeymen Stone Cutters' Association,* 274 U.S. 37 (1927).

[31] *Apex Hosiery Co.* v. *Leader,* 310 U.S. 469 (1940).

> The antitrust laws should not be used as an instrument to police strikes or adjudicate labor controversies. The right of collective bargaining by labor unions is recognized by the antitrust laws to be a reasonable exercise of collective power. Therefore, we wish to make it clear that it is only such boycotts, strikes or coercion by labor unions as have no reasonable connection with wages, hours, health, safety, the speed-up system, or the establishment and maintenance of the right of collective bargaining which will be prosecuted. . . .
>
> The types of unreasonable restraint against which we have recently proceeded or are now proceeding illustrate concretely the practices which in our opinion are unquestionable violations of the Sherman Act. . . .
>
> 1. Unreasonable restraints designed to prevent the use of cheaper material, improved equipment, or more efficient methods. . . .
> 2. Unreasonable restraints designed to compel the hiring of useless and unnecessary labor. . . .
> 3. Unreasonable restraints designed to enforce systems of graft and extortion. . . .
> 4. Unreasonable restraints designed to enforce illegally fixed prices.
> 5. Unreasonable restraints designed to destroy an established and legitimate system of collective bargaining.[32]

In the course of the drive of the Department of Justice to eliminate unreasonable restraints of trade, a number of indictments were returned against labor organizations and their leaders, particularly in the building industry. Labor spokesmen were quick to criticize the policy of the Department and renewed their efforts to secure specific exemption of labor from the Sherman Act. Meanwhile, the applicability of the Act to labor unions was being narrowed by judicial construction. "The Sherman Act," said Justice Stone in the *Apex* case, "was not enacted to police interstate transportation, or to afford a remedy for wrongs which are actionable under state law, and result from combinations and conspiracies which fall short, both in their purpose and effect, of any form of market control of a commodity. . . ." In *United States* v. *Hutcheson*,[33] where leading officers of the Carpenters' Union, an A.F. of L. affiliate, were indicted for violation of the Sherman Act because of acts committed in the course of a jurisdictional dispute with the Machinists' Union, another A.F. of L. affiliate, the Supreme Court ordered the indictments dismissed and held that the "use of conventional, peaceful activities of a union

[32] T. W. Arnold, *The Bottlenecks of Business* (1940), pp. 249–252.

[33] 9 U.S. Law Week 4151 (1941). Justice Roberts wrote a dissenting opinion in this case in which Chief Justice Hughes joined.

in controversy with a rival union over certain jobs" was not a violation of the Sherman Act. The effect of this decision on the program of the Department of Justice, particularly with reference to cases of "graft," "extortion," or other forms of labor racketeering, still remains to be determined.

THE LABOR INJUNCTION

If the Sherman Act was the chief legislative hindrance to organized labor, the injunction was by far the leading judicial obstacle. The former depended for its potency largely upon the latter. For in the four decades before 1932 the labor injunction became the predominant instrument of labor law. Through its terms the high-sounding expressions of reciprocal rights and duties laid down in the appellate courts were applied to the living reality of specific labor disputes. In the hands of unfriendly judges the injunction often proved a far stronger antiunion weapon than the substance of common-law or antitrust statutes. Hence the vehemence of labor animus against it, a feeling which was so widened during the postwar decade as to displace almost all other items in the political demands of the A.F. of L. In those years of organizational weakness, when the Federation was beset with internal strife, the single issue to which all labor would give its unequivocal support was relief from the injunction.

Injunctions were originally developed by equity courts in contexts wholly differing from modern industrial disputes. They were designed to prevent in advance irreparable damage for which adequate compensation could not be obtained in subsequent proceedings at law. Wide discretion was necessarily placed in the single judge, and the writ was given teeth by making violations punishable as contempts of court. In the federal courts, where controversy over the injunction was sharpest, the procedure was particularly loose. A temporary restraining order supported by a handful of affidavits describing in the most general terms the injury to be suffered from a strike could be issued by the court, on the employer's application, without notice to the union. After notice and summary hearing, it was followed by a temporary injunction, and in due course by full hearing and decision to make the injunction permanent. Appeals could be carried to higher courts on questions of law. From the labor viewpoint, the safeguards of due process at the later stages were generally Dead Sea fruit. The strike might well be broken by force of

the restraining order alone. Wholesale arrests of strike leaders frequently tilted the balance against a union by sapping its morale and identifying strikers in the public mind with common criminals. Time was of the essence of success or failure when industrial tension had reached the stage of crisis. Federal judges frequently directed their writs to "all persons whomsoever." The more far-reaching injunctions included in their prohibitions every variety of activity.

Imprisonment for contempt of court by the judge issuing an injunction, without jury trial, seemed to the worker to be an outright denial of basic civil liberties. In Gompers's view, the injunction meant "personal government foisted upon our people instead of a government by law." [34] Only in a few isolated instances was the writ employed in labor's favor.[35]

The Pyrrhic victory in labor's anti-injunction battle, represented by the Clayton Act of 1914, has been described above. As the courts in successive cases reiterated their interpretation of that statute as a mere restatement of pre-existing law, pressure intensified for a further and more effective attack on the labor injunction. One proposal popular in A.F. of L. circles would have prevented its use in protecting the "right to do business" simply by limiting the definition of "property" to things "tangible and transferable." [36] Although both major parties included anti-injunction planks in their 1928 platforms, the Republican attitude was less wholehearted in its condemnation, noting only that labor injunctions had "in some instances been abused and have given rise to a serious question for legislation." In consequence, only with the Democratic electoral successes of 1930, and with the imminence of another Presidential campaign, did positive action become possible. Under the leadership of Senator Norris of Nebraska and Representative (later Mayor) La Guardia of New York, a new federal anti-injunction bill was finally pushed to passage in 1932.

After lengthy public hearings, the simple proposal of the A.F. of L. was rejected as of doubtful practicability and more doubtful constitutionality. It was clear that the body of equity rules, procedural and substantive, required surgery rather than butchery, unless a great deal of value was to be lost in the process of eliminating un-

[34] F. Frankfurter and N. Greene, *The Labor Injunction* (1930), p. 53.

[35] Cf. particularly *Texas and New Orleans R.R. Co.* v. *Brotherhood of Railway and Steamship Clerks*, 281 U.S. 548 (1930).

[36] This proposal was introduced into the 70th Congress as the Shipstead Bill, S. 1482.

desirable features. The task was undertaken for the Senate Judiciary Committee by a distinguished group of legal specialists,[37] who drafted a bill closely similar to the final act. Record votes in Congress produced heavy majorities—75 to 5 in the Senate and 362 to 14 in the House.

The Norris-La Guardia Act set about with great care to remedy, one by one, the evils of the labor injunction and the weaknesses of the Clayton Act. It began with a striking declaration of policy:

> Whereas under prevailing economic conditions, developed with the aid of governmental authority for owners of property to organize in the corporate and other forms of ownership association, the individual unorganized worker is commonly helpless to exercise actual liberty of contract and to protect his freedom of labor, and thereby to obtain acceptable terms and conditions of employment, wherefore, though he should be free to decline to associate with his fellows, it is necessary that he have full freedom of association, self-organization, and designation of representatives of his own choosing, to negotiate the terms and conditions of his employment, and that he shall be free from the interference, restraint, or coercion of employers of labor, or their agents, in the designation of such representatives or in self-organization or in other concerted activities for the purpose of collective bargaining or other mutual aid or protection; therefore, the following definitions of, and limitations upon, the jurisdiction and authority of the courts of the United States are hereby enacted.

The substantive grounds upon which labor injunctions might be issued were limited in three respects. Yellow-dog contracts were made unenforceable in federal courts. Injunctions under the antitrust laws might no longer be more extensive than those based on the common law. And in no case might federal injunctions prohibit the following acts when performed by persons participating or interested in a labor dispute,[38] "whether singly or in concert":

> (a) Ceasing or refusing to perform any work or to remain in any relation of employment;

[37] Professor (later Justice) Frankfurter, Herman Oliphant, Professor Francis B. Sayre, Professor E. E. Witte, and Donald Richberg.

[38] The term "labor dispute" is defined to include "any controversy concerning terms or conditions of employment, or concerning the association or representation of persons in negotiating, fixing, maintaining, changing, or seeking to arrange terms or conditions of employment, regardless of whether or not the disputants stand in the proximate relation of employer and employee."

(b) Becoming or remaining a member of any labor organization or of any employer organization, regardless of any such undertaking or promise as is described in section 3 of this Act [the section dealing with yellow-dog contracts];

(c) Paying or giving to, or withholding from, any person participating or interested in such labor dispute, any strike or unemployment benefits or insurance, or other moneys or things of value;

(d) By all lawful means aiding any person participating or interested in any labor dispute who is being proceeded against in, or is prosecuting, any action or suit in any court of the United States or of any State;

(e) Giving publicity to the existence of, or the facts involved in, any labor dispute, whether by advertising, speaking, patrolling, or by any other method not involving fraud or violence;

(f) Assembling peaceably to act or to organize to act in promotion of their interests in a labor dispute;

(g) Advising or notifying any person of an intention to do any of the acts heretofore specified;

(h) Agreeing with other persons to do or not to do any of the acts heretofore specified; and

(i) Advising, urging, or otherwise causing or inducing without fraud or violence the acts heretofore specified, regardless of any such undertaking or promise as is described in section 3 of this Act.

New procedural limitations were also thrown about the use of the labor injunction. Temporary or permanent injunctions might be issued only after the hearing of witnesses in support of the complaint in open court, subject to cross-examination, and after formal court findings to the effect:

(a) That unlawful acts have been threatened and will be committed unless restrained or have been committed and will be continued unless restrained, but no injunction or temporary restraining order shall be issued on account of any threat or unlawful act excepting against the person or persons, association, or organization making the threat or committing the unlawful act or actually authorizing or ratifying the same after actual knowledge thereof;

(b) That substantial and irreparable injury to complainant's property will follow;

(c) That as to each item of relief granted greater injury will be inflicted upon complainant by the denial of relief than will be inflicted upon defendants by the granting of relief;

(d) That complainant has no adequate remedy at law; and

(e) That the public officers charged with the duty to protect complainant's property are unable or unwilling to furnish adequate protection.

Upon allegation by a complainant of unavoidable and irreparable injury to his property, supported by sworn testimony sufficient to justify a temporary injunction, a court might issue without notice a temporary restraining order valid only for five days, after the filing of a bond by the complainant sufficient to recompense defendants for consequent loss or damage. Before obtaining equitable relief, a complainant must also comply with all legal obligations involved in the dispute and "make every reasonable effort to settle such dispute either by negotiation or with the aid of any available governmental machinery of mediation or voluntary arbitration." Court orders might prohibit only specific acts complained of and included in the court's findings of fact. Appeals were expedited. Provision for jury trial in contempt cases was strengthened. Union officers or members, and the unions themselves, were no longer to be held liable for unlawful acts of individual members, "except upon clear proof of actual participation in, or actual authorization of, such acts, or of ratification of such acts after actual knowledge thereof." Seventeen states, moreover, covering most of the important industrial areas of the country, followed the federal model with "baby Norris-La Guardia Acts." [39]

Carefully drafted as it was, the new statute still required sympathetic judicial interpretation if its purposes were to be fulfilled. A few early decisions attempted to limit its scope through an unwarrantedly narrow definition of the term "labor dispute," but on the whole the courts have recognized the purpose of Congress and adopted "a complete change of practice and attitude." [40] Constitutionality of its procedural requirements has been upheld in the Supreme Court,[41] and the same tribunal has affirmed a broad interpretation of the scope of the act.[42] In a recent decision, handed down in 1940, the Supreme Court made clear that the jurisdictional prerequisites of the Norris-La Guardia Act must be complied with before

[39] The count is for the year 1939. In the course of the political reaction which set in against organized labor after 1937, the Wisconsin and Pennsylvania anti-injunction laws were narrowed in scope.

[40] H. N. Monkemeyer, "Five Years of the Norris-La Guardia Act," 2 *Missouri Law Review* 1, 2 (January, 1937).

[41] *Lauf* v. *E. G. Shinner & Co.*, 303 U.S. 323 (1938).

[42] *New Negro Alliance* v. *Sanitary Grocery Co.*, 303 U.S. 552 (1938). Cf. also *Fur Workers Union No. 21238* v. *Fur Workers Union, Local No. 72*, 308 U.S. 522 (1939) affirming *per curiam* 105 F. (2d) 1 (A.C.D.C., 1939); see also *Wilson and Co.* v. *Birl*, 105 F. (2d) 948 (C.C.A. 3d. 1939).

injunctive process can be used against a labor union accused of violating the Sherman Act. "For us to hold," said Justice Black for a unanimous Court, "that the federal courts have jurisdiction to grant injunctions in cases growing out of labor disputes, merely because alleged violations of the Sherman Act are involved, would run counter to the plain mandate of the [Norris–La Guardia] Act and would reverse the declared purpose of Congress." [43]

Although final definitive interpretation of its substantive provisions is yet to be supplied, the Norris–La Guardia Act has unquestionably satisfied the major portion of labor grievances against the injunction. Wholesale imprisonment for contempt under loosely worded and all-inclusive writs is probably a thing of the past. The rules of equity can no longer easily be manipulated into a direct ally of employers in the course of industrial warfare—at least in federal courts.

MEDIATION, CONCILIATION, AND ARBITRATION

Ever since the modern pattern of industrial relations was formed within the economic order, government agencies at the local, state, and federal levels have used their good offices to obtain adjustment and voluntary settlement of labor disputes. Without special legal authority, city mayors have traditionally intervened in situations threatening stoppage of services essential to the continuity of urban life. Governors and Presidents have played a similar role in larger areas. Informal mediation or conciliation [44] may often avert or shorten the duration of actual stoppage, eliminating hardship to both sides and to the public at large. It is ordinarily undertaken on the initiative of the executive or at the request of either party.

Arbitration is a more formalized process, generally eventuating in an award by an impartial board on disputed claims as to rights and

[43] *Milk Wagon Drivers Union, Local No. 753 et al.* v. *Lake Valley Farm Products, Inc., Amalgamated Dairy Workers, Local Industrial Union No. 819, et al.,* 9 U.S. Law Week 4024, 4026 (1940). See also the comments of Justice Frankfurter in *U.S.* v. *Hutcheson,* 9 U.S. Law Week 4151 (1941): "The underlying aim of the Norris–La Guardia Act was to restore the broad purpose which Congress thought it had formulated in the Clayton Act but which was frustrated, so Congress believed, by unduly restrictive judicial construction. . . ."

[44] In general usage, these terms are almost interchangeable. Mediation connotes the function of a "go-between," a channel of communication between the parties unable to meet directly because of the bitterness of disagreement or the politics of industrial warfare. Conciliation suggests aid in promoting agreement by conference.

duties. As union recognition is extended, this function becomes increasingly important, centering about the interpretation of trade agreements. Elaborate machinery, both private and public, has been established for arbitration purposes. Awards are frequently made binding when both parties have agreed to submit their differences to an arbitration tribunal.

Specialized governmental machinery for conciliation and arbitration was first set up by the states of Massachusetts and New York in 1886. Most states now provide some such type of machinery, varying greatly in adequacy of operating personnel and in effectiveness. In the organic act of the federal Department of Labor, passed in 1913, the Secretary was specifically empowered "to act as mediator and to appoint commissioners of conciliation in labor disputes whenever in his judgment the interests of industrial peace require it to be done." This mandate is carried out through the United States Conciliation Service, with some sixty commissioners. They intervene in strikes or potential strike situations at the request of either party or of local officials, and in rare cases of unusual public significance on their own initiative. In recent years, they have been asked with increasing frequency to serve as arbitrators.

During the war of 1914–18, federal adjustment machinery was greatly extended, as the pressure of rising prices on living standards and the labor shortage in many fields stimulated industrial conflict. The Wilson administration emphasized a preference for conciliation over compulsion. Mediation boards, representing employers and employees on an equal basis, were established for each leading industry, with the machinery capped by the National War Labor Board. The Board first formulated as official doctrine a policy later adopted by Congress in the National Labor Relations Act, recognition of the right of workers (as well as employers) to organize and to bargain collectively through representatives of their own choosing. Although it did not eliminate all strikes by any means, the machinery aided substantially in smoothing industrial relations in a most difficult period of transition. Contrary to the policy in many other belligerent nations, the federal government did not outlaw strikes or apply direct compulsion to the settlement of disputes. In a number of states, however, compulsory work laws were enacted.[45]

In the postwar reaction against government intervention of all

[45] See Hoague, Brown, and Marcus, "Wartime Conscription and Control of Labor," *Harvard Law Review*, Vol. 54, p. 50 (November, 1940).

sorts, the federal war-labor-adjustment machinery was wholly swept away. At the same time, a short-lived experiment was made with compulsory arbitration by the state of Kansas. A law passed in 1920, limited to the public utility, coal, food, and clothing industries, established a "court of industrial relations" of three members, empowered to make binding decisions in controversies threatening stoppage of work. Strikes or lockouts after a decision were forbidden. The act was applied in a number of major disputes, but its principle was never accepted by organized labor in the state, and the court was frequently ignored. Its scope was limited by a Supreme Court decision finding it inapplicable in industries not "affected with a public interest," a phrase at that time restricted to the traditional public utilities.[46] After 1923 the court ceased to function and the act became dormant. American unions have consistently rejected proposals for compulsory arbitration under normal peacetime conditions. Experiments of this type in Australia and New Zealand, which have met with considerable favor in Australasian labor circles, have not been regarded by American labor as desirable models. While a few employer groups and some students advocated compulsory arbitration during the severe industrial disputes of the thirties, evolution of public labor policy along this line appeared unlikely, at least until the national defense preparations of 1940.[47]

RAILROAD LABOR LEGISLATION

Public adjustment machinery has been most highly developed in the railroad field. The basic importance of railroads as the sole rapid transportation facility prior to the motor truck, and the enormous consequences on community life resulting from even a brief stoppage, have led to a series of attempts by the federal government to prevent strikes through regularized intervention. Experimentation for more than half a century with an assortment of mediation and arbitration agencies has evolved machinery which strikes a careful balance between voluntary adjustment and public influence. Without withholding the ultimate right to strike, the law surrounds that right with limitations in keeping with the unique public significance of the industry. At the same time, it uses every expedient to promote peaceful agreements between the freely chosen representatives of both par-

[46] *Wolff Packing Co.* v. *Court of Industrial Relations*, 262 U.S. 522 (1923).

[47] Under the pressure of war emergency some unions manifested an increased readiness to accept compulsory arbitration.

ties. The machinery has unquestionably contributed to an unmatched record of almost unbroken industrial peace since the shopmen's strike of 1922. Success of conciliation and arbitration in railroad operations, however, has depended upon the development of free labor organization from the bitter and bloody struggles for recognition in the eighties, through the competition of company unionism in the postwar decade, to an almost universally recognized status of responsibility and equal participation in bargaining for trade agreements on a nation-wide scale. Effective guarantee of free representation has evolved as a necessary condition of effective conciliation and arbitration.

Railroad labor legislation began in 1888, with a statute providing for voluntary arbitration with the consent of both parties, and investigation of disputes by temporary commissions appointed by the President. The arbitration provisions were mere pious wishes, without sanctions for enforcement, and were not used during the ten-year life of the Act. The investigation provisions also proved ineffective. In the Erdman Act of 1898, the seeds of modern law first made their appearance. The Act provided in specific terms for mediation and conciliation by the chairman of the Interstate Commerce Commission and the Commissioner of Labor, on the request of either party to the dispute. If unsuccessful, they were to endeavor to bring about arbitration. The latter function was to be performed by special boards of three members, one selected by each party and the third by the two thus chosen, or if they failed to agree, the third could be chosen by the two government officials designated as mediators. Submission of a dispute remained voluntary, but awards were binding and enforceable by court order.[48]

For the first few years no use was made of the Erdman Act. Railroad management was not yet generally converted to union recognition. As the unions gained in strength in the years before the war, however, the Act was invoked in sixty-one cases, all but sixteen of which were settled without arbitration. Success of the mediation feature led to its strengthening by the Newlands Act, passed in 1913 with the support of both railroad management and labor. A permanent Board

[48] During the subsequent three months neither strikes nor dismissals by reason of dissatisfaction with an award were permitted except on thirty days' notice. Nor could there be a change in the *status quo* pending decision of a board. The Act also sought to outlaw yellow-dog contracts and forbid antiunion discrimination, but this provision was invalidated by the Supreme Court in 1908.

of Mediation and Conciliation was created, composed of a full-time Commissioner and two other high government officials designated by the President. The Board was empowered to intervene in serious disputes on its own initiative, as well as on the request of either party. It might also serve in a quasi-judicial capacity to interpret agreements reached through conciliation. For three years the record under this statute compared favorably with that under the Erdman Act. In 1916, however, the increasingly powerful unions refused to use its machinery in the dispute over their claim for the eight-hour day. A strike was averted at the eleventh hour only by direct Congressional action—passage of the Adamson Act [49] at the urgent behest of President Wilson.

In the period of federal control, from 1917 to 1920, public policy encouraged the growth of free organization by forbidding antiunion discrimination and by introducing nation-wide trade agreements on hours, wages, and working conditions. Wages were adjusted upward in harmony with increases elsewhere up to 1919. An eminently successful innovation established three bipartisan Boards of Adjustment to decide controversies over the interpretation or application of wage agreements for the three broad classes of employees. Like organized labor in general, the railway unions made great strides during the war years. They sought the retention of federal control after the war under the "Plumb plan," and vainly opposed enactment of the Esch-Cummins Law of 1920, which restored the roads to private ownership.[50]

In Title III of the Act of 1920, most of the lessons of previous decades were cast aside. Under the inspiration of proponents of compulsory arbitration, the law created a full-time Railroad Labor Board of nine members, dignified by $10,000 salaries. Unwilling to accept the principle of compulsion itself, however, Congress gave the Board all the attributes of a quasi-judicial tribunal except the fundamental of sanctions for enforcement of awards. An abortive effort was made to set out standards for wage decision, but the phraseology was so broad as to create more difficulties than it solved. Mediation machinery was abandoned. It was merely declared to be the duty of the carriers and the workers to attempt to avoid stoppages by conference, before using the arbitration machinery. A permissive section envisaged establishment of bipartisan regional or functional Railroad Boards of

[49] See above, pp. 140–141.
[50] See Chapter 9.

Labor Adjustment; very few were, in fact, established. The Act also omitted guarantees of freedom of organization.

The new machinery was distrusted by the unions from the start. It failed to prevent the great shopmen's strike of 1922. Although the Board's membership was supposed to represent equally employers, employees, and "the public," the latter members were considered grossly biased toward the carriers. This view was confirmed when the Board gave open approval to company unionism, which now flourished on the railroads for the first time. Nor did the Board obtain the unexceptional confidence of the roads. Several of them ignored its awards, and the Supreme Court in due course affirmed their contention, evidently justified on the face of the Act, that enforcement rested solely on publicity.[51]

In 1926, therefore, with the approval of both parties, Congress passed the Railway Labor Act, which remains the basic law in this field. Amendments in 1934, promoted by the unions together with the Federal Co-ordinator of Transportation,[52] further strengthened the Act, elaborating its provisions against company unionism, thoroughly differentiating the various stages in the process of adjustment, and setting up appropriate machinery for each. Returning to the model of the Erdman and Newlands Acts, this statute provides for mediation of disputes not settled by conferences through a full-time, three-member National Mediation Board, on request of either party or on its own motion.[53] The Board has no quasi-judicial authority and plays only a minor role in arbitration.

If mediation fails, the Board endeavors to bring about arbitration, but initiation of arbitration is wholly voluntary, requiring the consent of both sides. This function devolves on *ad hoc* boards of three or six, one (or two) chosen by each of the parties immediately concerned, with the remaining members selected by the "partisan" arbitrators. Only if they fail to agree on these members does the Mediation Board intervene, itself selecting them. Arbitration awards are bind-

[51] *Pennsylvania Federation* v. *Pennsylvania R.R. Co.*, 267 U.S. 203 (1925).

[52] For the creation and duties of this office, see below, pp. 285–289.

[53] By the Act of April 10, 1936, 49 Stat. 1189, all the provisions of the amended Railway Labor Act, except those providing for regional and national boards of adjustment, were extended to common carriers by air. Provision was also made for the establishment of system, group, or regional boards of adjustment; and the statute envisaged the ultimate creation of a National Air Transport Adjustment Board, whenever in the judgment of the National Mediation Board it should prove necessary in order to provide for prompt settlement of disputes in the air transport industry.

ing upon the parties for such period as they may prescribe, are subject to "impeachment" and judicial review on limited grounds of law, and are enforceable as court orders. While of substantial importance in the period 1926–34, the arbitration machinery is now only rarely used, being supplanted almost completely by the National Railroad Adjustment Board.

The National Mediation Board is also given the important task of certifying labor representatives for collective bargaining purposes. As strengthened by the 1934 amendments, the Railway Labor Act forbids company unions in unequivocal terms. It specifically permits employees to be represented by nonemployees of a railroad, i. e., officers of a national union. After certification by the Board, the roads must negotiate in good faith with the authorized representatives, although agreement is of course not compelled.[54] Carriers may not interfere with labor organization in any way, either by promoting their own unions or by hindering independent ones. Yellow-dog contracts are forbidden. The prohibitions are backed by criminal penalties.

While these unfair labor practices closely approximate those forbidden by the general National Labor Relations Act of 1935, the unions must depend for their enforcement upon the ordinary processes of the courts,[55] without the aid of a special administrative tribunal. The long tradition of organization among the operating employees places the railway unions in a favorable position by comparison with those in industry at large, for their task is the relatively simple one of maintaining status rather than of obtaining membership and recognition for the first time.

Railway mediation procedure makes the utmost use of delay, looking to a "cooling period" to foster voluntary adjustment of disputes. Thirty days' notice is required for changes in agreements on wages, rules, or working conditions, and the *status quo* must be maintained until final action by the Mediation Board. Moreover, if all the adjustment machinery fails to settle a dispute, and the Board deems it to "threaten substantially to interrupt interstate commerce to a degree

[54] Cf. *Virginian Railway Co.* v. *System Federation No. 40,* 300 U.S. 515 (1937).

[55] The most striking case of the use of an injunction on behalf of organized labor is afforded by *Texas & New Orleans Railroad Co.* v. *Brotherhood of Railway and Steamship Clerks,* 281 U.S. 548 (1930), where the union secured a decree against maintenance of a rival company union, under the 1926 Act. It is generally felt that the addition of criminal penalties in 1934 greatly strengthens the "unfair labor practice" features of the statute.

such as to deprive any section of the country of essential transportation service," the President may create a special emergency board of disinterested persons to make an investigation and report. Their report is to be made within thirty days after appointment, and conditions are to be maintained without change (except by agreement), both pending the report and for a further thirty days thereafter.

Emergency boards have been created only rarely, averaging less than two a year. They depend for effectiveness solely on the influence of public opinion and the persuasiveness of their reports. Generally composed of members of unusual distinction, they have effected peaceful settlements almost without exception, although they have entered the negotiations only at a stage close to open warfare.[56] Reports are made public and, of necessity, carry weight in an industry which so universally affects the public at large.

The amendments of 1934 also revived the adjustment boards of wartime by establishing a thirty-six-member National Railroad Adjustment Board, operating in four functional divisions. Each division represents both parties equally. Deadlocks may be resolved by a neutral "referee" appointed by mutual consent or by the Mediation Board; referees prove necessary in practice in slightly more than half the cases. The Board has jurisdiction, on petition of either party, over disputes "growing out of grievances or out of the interpretation or application of agreements concerning rates of pay, rules, or working conditions," after efforts to settle them by ordinary negotiations have failed. The Board operates in a fashion somewhere between arbitration and quasi-judicial decision. Its orders may be enforced only after court review at the instance of the winner, in which the Board's action is to be taken as *prima facie* evidence of the facts. All but a handful among the thousands of awards, however, have received voluntary compliance without court action.

The intensity of partisanship varies among the four divisions of the Board, being most intense in Division I, which deals with train-and-yard-service employees and handles the great bulk of the cases.[57] Frequent deadlock, over procedural as well as substantive issues, has

[56] Outstanding in this respect was the board appointed in the autumn of 1938, consisting of Judge Stacy of North Carolina, Dean Landis of the Harvard Law School, and Professor Millis of Chicago, whose report led to a withdrawal of proposals for a general 15 per cent wage reduction and thus avoided a threatened nation-wide strike.

[57] For a thorough discussion of the Board's procedure and record, cf. Attorney General's Committee on Administrative Procedure, *Railway Labor* (1940).

put this division several years behind in its calendar, and its operations clearly leave a wide margin for improvement. Yet the Board offers one great pragmatic merit: its very weaknesses and indefiniteness of character make it acceptable to both parties. Where compulsory arbitration and formal quasi-judicial decision would fail of recognition, the somewhat clumsy machine of the Adjustment Board is at least tolerated.

In a review of the history of railroad labor legislation over the past half century, two conclusions stand out from the variety of Congressional experiments. Given the basic condition of an industry so vital to the public that either party will risk the opprobrium of responsibility for stoppage only under the greatest pressure, government intervention seems most effective when concentrated on encouragement of voluntary adjustment. And since equality of status and mutual respect of the parties is a necessary prerequisite of successful adjustment, government is of primary importance as the guarantor of free organization and effective labor representation. Yet it is not to be supposed that similar industrial peace could be generally achieved merely by transplanting railroad adjustment machinery to industry at large. Experience over a wide area abroad, and in the few industries at home with a long history of organization, suggests the indispensability of recognized labor status to continued industrial harmony. The alternatives are chronic and bitter disputes over recognition or a form of government compulsion which is incompatible with the bases of our political and economic order.[58]

[58] Success of public adjustment machinery in the railroad industry has led to repeated proposals for its application to maritime labor. Influenced by the instability and chronic strife characteristic of industrial relations in this area, Congress in January, 1938, provided for the creation of a Maritime Labor Board of three members, with duties corresponding in general to those of the National Mediation Board. During its first two years, the Maritime Labor Board approached its task with circumspection. It has operated with a budget of only $190,000 and a staff of less than forty. Up to September, 1939, it had intervened in seventy-three disputes and aided in the settlement of twenty-five strikes. Its staff of mediators was raised from four in 1939 to eight in 1940. In its general policy report of 1940, the Board noted the ineffectiveness of local adjustment boards and of arbitration in the maritime industry and devoted a substantial part of its inquiry to efforts to determine the underlying obstacles to satisfactory collective bargaining. In the same report, it recommended a continuance of the experiment in mediation, coupled with proposals designed to promote the more rapid realization of stable collective bargaining. In particular it proposed that representation questions be transferred from the NLRB to itself, that shipping subsidies be conditioned upon compliance with the National Labor Relations Act, that it be authorized to establish adjustment boards with the consent of both parties, that

3. Labor Under the New Deal

On the eve of the New Deal the membership of the American Federation of Labor was down to little over two million. With the advent of the Roosevelt administration, the outlook for the labor movement was suddenly transformed. The new administration was disposed to be friendly and sympathetic to labor. The possibility of using government as a positive instrument to realize labor's widening objectives quickly became apparent. Under the stimulus of the National Industrial Recovery Act, union membership shot up. The initial gains made by the mine workers and the needle trades were quickly extended to the hitherto unorganized basic mass production industries.

Soon the old issue of craft versus industrial unionism was again rife. "Federal locals" for the newly organized were viewed by the craft leaders of the A.F. of L. as merely temporary devices, to be maintained only until their members could be apportioned among appropriate craft unions. The resultant dissension, coupled with a revival of strong antiunionism among employers, tended to nullify many of the gains of 1933 and 1934. In revolt against the official A.F. of L. attitude, leaders of the United Mine Workers, the Amalgamated Clothing Workers, the International Ladies' Garment Workers, and other industrial unions within the Federation, headed by John L. Lewis of the miners, determined to organize the unskilled on their own account. They established a Committee for Industrial Organization in 1935 and were suspended from the Federation in the following year. In 1938, the C.I.O. became the Congress of Industrial Organizations, with a wholly independent constitutional framework.

C.I.O. successes in 1936 and 1937 were spectacular. They included widespread unionization for the first time in rubber, automobiles, and steel. Recognition by the United States Steel Corporation was the most striking union accomplishment in decades. Late in 1937, however, the C.I.O. was defeated in a long-drawn-out strike against four of the major independent steel companies.

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it should be empowered to appoint paid umpires for disputes, at the request of both parties, and that, in accordance with the model of the Railway Labor Act, it be authorized to appoint neutral arbitrators. The Board also remarked upon a shift in emphasis in maritime labor disputes away from union recognition to substantive issues like wages, working conditions, and the control of hiring halls. This tendency was interpreted as an indication of increasingly accepted status for union organization and the practice of collective bargaining, upon the basis of which in time workable mediation and arbitration procedures might be built.

The split in the labor movement was followed by vigorous recriminations, personal and otherwise, between leaders of the two organizations. The A.F. of L. declared war on the C.I.O. as a revival of radical dual unionism, of the sort which in the past had only disrupted America's labor forces. The C.I.O. retorted that A.F. of L. leadership had given no heed to the mass of American workmen, that craft domination produced fruitless jurisdictional quarrels and toleration of labor racketeering, and that the C.I.O. alone was organizing labor on behalf of a reconstructed social order. The C.I.O., in its turn, suffered from internal dissension, leading both to a split within the United Automobile Workers and the secession of the International Ladies' Garment Workers. Efforts to reunite the A.F. of L. and the C.I.O. have thus far been unavailing, although the split has alienated a good deal of public sympathy and reduced the effectiveness of labor as a political force. Whatever the future, the C.I.O.'s emergence is significant as an attempt to reshape the structure of organized labor in harmony with the modern structure of industry.

On the whole, the years since 1933 have marked a milestone in the development of government's attitude toward organized labor. A long tradition of aloofness or hostility, to some extent modified during the first World War, was suddenly transformed into recognition, sympathy, and, with some exceptions, open friendliness. Union membership reached a peak of approximately eight millions, almost twice its previous record. Labor legislation, both protective and promotive of organization, was extended to unprecedented lengths.

THE NATIONAL INDUSTRIAL RECOVERY ACT

The significance of the National Recovery Administration as an experiment in industrial control is analyzed in Chapter 16 below. Its importance as a progenitor of New Deal labor policies, however, requires separate treatment. Under the now famous Section 7(a) of the National Industrial Recovery Act all NRA codes were required to contain the following provisions:

(1) That employees shall have the right to organize and bargain collectively through representatives of their own choosing, and shall be free from the interference, restraint, or coercion of employers of labor, or their agents, in the designation of such representatives or in self-organization or in other concerted activities for the purpose of collective bargaining or other mutual aid or protection;
(2) That no employee and no one seeking employment shall be required

as a condition of employment to join any company union or to refrain from joining, organizing, or assisting a labor organization of his own choosing; and

(3) That employers shall comply with the maximum hours of labor, minimum rates of pay, and other conditions of employment approved or prescribed by the President.

Under the impetus of Section 7(a) an organizing movement spread through the ranks of American labor. Between the summer of 1933 and the winter of 1934–35 membership in the A.F. of L. unions increased by more than a million. Unions which conducted aggressive organizing campaigns made the greatest gains; others were less effective. Nevertheless, the very existence of the collective bargaining provisions of the NIRA served as a profound stimulus to trade-union organization.

The National Recovery Administration also involved a new method of enacting protective labor legislation on a nation-wide industry basis. The code-making process, in which government, employers, and trade-unions shared responsibility, offered an opportunity to shape labor standards, to outlaw child labor, to fix minimum wages, maximum hours, and other conditions, and to give these standards a legal status. Again, it must be noted, labor could use its power most effectively only in industries where it was strongly organized. In such industries labor's new-found power was sometimes skillfully employed to expand the area of trade-union influence by eliminating or limiting the differential advantage of the unorganized regions and the nonunionized employers.

The NRA experiment, to be sure, brought severe criticism from many labor leaders. Those who expected it to usher in a labor millennium were disappointed. Many employers bitterly resisted the spread of unionism, and their influence penetrated into the inner councils of the National Recovery Administration. Difficulties developed over the interpretation of Section 7(a). Representatives of organized labor contended that Section 7(a) required the National Recovery Administration to promote the unionization of workers, while the NRA high command took the position that this responsibility rested upon the workers. Disputes developed with respect to the status of company unions and the question of whether Section 7(a) required the representation of minority as well as majority groups among the workers.

Despite these disputes and difficulties, the National Industrial Re-

covery Act struck a new balance in employer-employee relationships. It represented an effort to provide a legal environment in which unionism could take root and flourish. It sought to raise labor standards on a national scale. It made at least some tentative gestures in the direction of giving labor a voice in the determination of industrial and business policies. As labor's economic and political strength increased during the next years, strenuous efforts were made to extend each of these gains further.

THE WAGNER ACT AND THE WORK OF THE NLRB

The origins of the present National Labor Relations Board are traceable to NRA experience. The National Industrial Recovery Act itself made no provision for the settlement of disputes growing out of its labor provisions. After an outbreak of strikes during the early summer of 1933, President Roosevelt by executive order established the National Labor Board, composed of representatives of industry and labor, with Senator Wagner acting as chairman. Subsequently, special boards for certain industries were created either under their codes or by executive order; the National Labor Board took jurisdiction over alleged violations of Section 7(a) in all other industries. At first, when the prestige of the Board was great, and the disposition to obey the Recovery Act strong, the Board and its regional subdivisions succeeded in settling a large number of labor disputes. But, after a few months, the Board's effectiveness was seriously undermined. The informal character of its authority, dissension among members of the Board itself, lack of sanctions, the notorious ambiguities of Section 7(a), and the defiance of the Board's orders by several large companies combined to destroy its usefulness.

The National Labor Board was succeeded in July, 1934, by the first National Labor Relations Board. The authority of this Board, instead of deriving from an executive order of the President, was established by joint resolution of Congress. It was empowered to deal with controversies arising under Section 7(a) and to conduct elections to determine employee representatives for collective bargaining. This Board, which was composed of three members appointed by the President, was subject to many of the same handicaps as the original Wagner Board. It was, if anything, even less successful in obtaining compliance with its decisions. The new Board's jurisdiction was based on the National Industrial Recovery Act, and when that statute was invalidated by the Supreme Court in the *Schechter*

case [59] the Board, too, was extinguished. Meanwhile, however, in carrying on its work valuable experience was accumulated; and from its written opinions were derived many of the principles of the code of unfair labor practices—a code which was later embodied in the National Labor Relations Act.

The National Labor Relations Act of 1935 became law within less than a month and a half after the invalidation of the NIRA. Administration of the Act was placed under the direction of a Board of three members, appointed by the President with the consent of the Senate. Section 7 of the new Act, in effect, echoed the language of Section 7(a) of the NRA. It declared the right of employees to self-organization and to bargain collectively through representatives of their own choosing. But whereas 7(a) stated the right of employees in general terms, Section 8 of the new Act in its definition of unfair labor practices gave specific directions as to the duties of employers.

Section 8 set forth five unfair labor practices. The first was a catch-all. It forbade employers "to interfere with, restrain, or coerce employees in the exercise of the rights guaranteed in Section 7." The second was directed against company-dominated unions. It forbade employers "to dominate or interfere with the formation or administration of any labor organization or contribute financial or other support to it." The third unfair labor practice involved discriminations affecting union membership. Employers were forbidden to discriminate in regard to "hire or tenure of employment, or any term or condition of employment, to encourage or discourage membership in any labor organization." The fourth practice outlawed by the Act was the discharge of, or discrimination against, an employee for having filed charges or testified under the Act. The fifth unfair labor practice, refusal to bargain collectively with the employee representatives, placed an affirmative duty on the employer. This duty was to bargain, not necessarily to agree.[60]

Section 9 of the Act set up machinery to determine employee representatives for collective bargaining. This section adopted the principle of majority rule. It provided that the representatives chosen for collective bargaining purposes by the majority of the employees in a

[59] 295 U.S. 495 (1935).

[60] But note the words of Justice Stone in *Heinz Co.* v. *NLRB* (1941): "It is true that the National Labor Relations Act, while requiring the employer to bargain collectively, does not compel him to enter into an agreement. But it does not follow . . . that, having reached an agreement, he can refuse to sign it, because he has never agreed to sign one." See 9 U.S. Law Week 4118.

unit appropriate for such purpose should be the exclusive representatives of all the employees in such a unit. Complete discretion was vested with the Board to determine the appropriate bargaining unit. It was to decide whether the appropriate unit should be "the employer unit, craft unit, plant unit, or subdivisions thereof." This clause was inserted in the Act when legislators could not anticipate the split in the labor movement which later developed. Section 9 also authorized the Board to investigate any controversy concerning representation and to certify the representatives designated or selected. In so doing it was empowered to take a secret ballot of employees or utilize any other suitable method.

The Act also set forth provisions governing the enforcement of Board orders. The Board was empowered to issue orders to employers to cease and desist from specified unfair labor practices which interfered with the right of employees to organize. These orders were to be enforced not by the Board but by the courts, and they were made reviewable by the courts. Violation of the Board's order itself carried no penalty. The Board was required to petition a United States circuit court of appeals to enforce its order. Any person aggrieved might obtain a review in the appropriate circuit court of appeals. If the legal issue in question justified the step, an appeal could be taken to the Supreme Court. The Board's findings of facts, if supported by evidence, were to be conclusive. In cases where the Board certified representatives for bargaining purposes, the provisions for review differed. Such certification was reviewable in the circuit court of appeals only when it accompanied an order to an employer to bargain collectively with the certified representative.[61]

The procedure followed by the Board may be briefly described. When it is charged that an employer is engaged in an unfair labor practice, the regional director of the Board undertakes a preliminary investigation of the charge. If the charge seems to him unfounded he will refuse to issue a complaint. Such refusal, however, is subject to review by the Board. If the charge seems supported by evidence, the regional director attempts to secure voluntary compliance by the employer. If this fails, he issues a formal complaint. The Board then sends a trial examiner from Washington to hold a hearing. At this hearing, the Board is represented by counsel, usually the regional attorney, and the employer may be represented by his own counsel.

[61] See *American Federation of Labor et al.* v. *NLRB,* 308 U.S. 401 (1940), upholding the constitutionality of this process.

Following the hearing the trial examiner is required to file an intermediate report which is served on the parties. This report contains the examiner's findings of fact and his recommendations as to the disposition of the case. Exceptions to the report may be filed with the Board. If the party against whom the charge is filed so desires, the proceeding may then be taken for a hearing before the Board itself. The Board then makes its own findings of fact and issues an order. An appeal may be taken from this order to the courts.[62]

Procedure in representation cases is somewhat different. Until 1939 only employees could petition for Board action. Under the new rules, however, employers' petitions for elections may also be accepted at the discretion of the Board. When a petition is filed with a regional director to investigate a controversy concerning representation, the regional director makes a preliminary investigation and recommends action to the Board. The Board then determines whether the regional director shall proceed. If it so decides, the regional director conducts the formal investigation, and provides for a hearing at which the rival claimants can develop their contentions. A trial examiner presides and an appeal can be taken to the Board as in the case of unfair labor practices.

In examining the administrative record of the National Labor Relations Board, it is necessary to recall the environment in which it was compelled to function and the nature of the pressures which impinged upon it. At the threshold it was met by employer hostility and a barrage of lawsuits designed to restrain proceedings under the Act and to test its constitutionality. Until the Supreme Court spoke [63] in

[62] In February, 1941, important changes were made in the procedure of the Board. Under the earlier practice the Board relied heavily on its Review Division in preparing opinions and passing on the work of Trial Examiners. Many of the review attorneys were subjected to severe criticism on the ground of their youth and inexperience. Under the new procedure greater responsibility is to be placed on the trial examiners. The review attorneys, instead of reporting orally to the Board and preparing draft opinions, are merely to submit written memoranda summarizing and analyzing the case record which the Board can then compare with the intermediate report of the trial examiner. Other changes made by the Board include reducing the formerly strategic position of executive secretary to that of office manager; delegating more responsibility to regional directors; and establishing a new administrative division to supervise the work of its regional offices and to oversee the issuance of complaints and authorization of proceedings in representation cases.

[63] See *The Associated Press* v. *National Labor Relations Board,* 301 U.S. 103; *Washington, Virginia and Maryland Coach Co.* v. *Same,* 301 U.S. 142; *National Labor Relations Board* v. *Jones & Laughlin Steel Corp.,* 301 U.S. 1; *National Labor Rela-*

April, 1937, nearly two years after the passage of the Act, the Board's activities were virtually paralyzed. After the Supreme Court had finally handed down its decisions upholding the validity of the Act, an avalanche of business descended upon the Board with which its insufficient personnel had great difficulty in coping. Meanwhile, the controversy between the A.F. of L. and the C.I.O. was rapidly coming to a head. As the battle became more bitter, employers who were hostile to unionism were quick to take advantage of the split. The jurisdictional squabbles between the two union groups served to discredit unionism and to forfeit middle-class sympathy. It was in this context that the NLRB was compelled to operate. It could not count on the support of a united labor movement. It could count on the hostility of many employers. And as the feud between the A.F. of L. and the C.I.O. developed, the Board found itself inevitably involved, its decisions attacked by both sides.

The work of the Board divides itself into two main classes: (1) cases of alleged unfair practices on the part of employers, and (2) cases involving certification and representation questions. Both present their difficulties. Some unfair practices cases, to be sure, are relatively simple. When, for example, an employer creates a company union, contributes financial support to it, dictates the bylaws, and intimidates employees into membership, the Board finds it easy to conclude that the organization is employer controlled and to order its disestablishment under Section 8(2).[64] Or when an employee files charges against an employer, and the employee is then discharged for "running down there and causing all this trouble," [65] Section 8(4), which prohibits discharge for filing charges, is clearly applicable.

But most cases are not easy. They usually involve conflicting contentions which are difficult to resolve. While discharged employees may allege discrimination affecting union membership, employers may reply that the discharge has nothing to do with union activity, but is the result of inefficiency, insubordination, infraction of rules, or some other such cause. How shall the Board decide? It may put certain questions. Is there proof of the employer's antiunion bias? What of the discharged employee's service record? Is he being replaced by a

tions Board v. *Fruehauf Trailer Co.*, 301 U.S. 49; *National Labor Relations Board* v. *Friedman-Harry Marks Clothing Co.*, 301 U.S. 58. With the exception of the Coach Co. case, all of these were 5 to 4 decisions.

[64] See, e. g., *Pennsylvania Greyhound Lines, Inc.*, 1 NLRB 1 (1935).

[65] *Friedman-Harry Marks Clothing Co., Inc.*, 1 NLRB 411, 428 (1936).

nonunion worker? Is a high percentage of union men being discharged? Such questions may all be relevant in reaching a decision, but the facts necessary to answer them may be difficult to unearth; and even if some of them become available, reasonable men may still disagree in assessing their significance.

The Act raises many difficult problems of interpretation. Where an employer has discriminated against union members and the employees then go out on strike, may the Board order the employer to reinstate such employees? The Supreme Court in the *Mackay Radio and Telegraph* case[66] decided that striking employees were still within the protection of the Wagner Act and ordered their reinstatement.[67]

But what of employees who engage in a sitdown strike as a protest against a company's unfair labor practices? Are they, too, entitled to reinstatement? The NLRB argued in the *Fansteel* case[68] that they were, that the wrongs committed by the sitdown strikers did not suspend their rights under the Wagner Act. The Supreme Court disagreed. The majority, speaking through the Chief Justice, affirmed the Board's conclusion that the Fansteel Corporation had engaged in unfair labor practices preceding the sitdown strike, but it refused to reinstate the sitdown strikers and the employees who abetted them. "To do otherwise," said the Chief Justice, "would be to put a premium on resort to force instead of legal remedies and to subvert the principles of law and order which lie at the foundation of society."[69]

This decision raises interesting questions for the future. Does the opinion of the Court mean that the Board will be prevented from ordering the reinstatement of striking employees who violate any state laws or who become involved, for example, in violence on the picket line and are arrested?

[66] 304 U.S. 333 (1938).

[67] But see *Republic Steel Corp.* v. *NLRB* (1940), where the Supreme Court decided that the NLRB in ordering reinstatement of employees with back pay may not require the employer to pay over to governmental agencies amounts ordered deducted from back pay as earnings of employees for work performed upon work relief projects. Justices Black and Douglas dissented. See 9 U.S. Law Week 4019.

[68] 306 U.S. 240 (1939).

[69] Four justices concurred with the Chief Justice in full; Justice Stone concurred in part; Justices Reed and Black dissented. Justice Reed took the position that to reinstate the strikers would not necessarily have been to justify their conduct. Their conduct was punishable under local laws. "Disapproval of a sitdown," he said, "does not logically compel the acceptance of the theory that an employer has the power to bar his striking employee from the protection of the Labor Act."

Perhaps the most difficult problems which have plagued the Board have been those growing out of the rivalry between the A.F. of L. and the C.I.O. In a number of cases where employers have sought to forestall C.I.O. organizing efforts by entering into closed shop agreements with A.F. of L. unions, the NLRB has invalidated such agreements in order to give the employees themselves an opportunity to designate representatives of their own choice. In an important decision handed down late in 1940, the Supreme Court upheld the Labor Board in nullifying a closed shop contract entered into between the Serrick Corporation and an A.F. of L. craft union, because it had been "assisted" by unfair labor practices. The Court ordered that the employer must bargain exclusively with the industrial union against which the collusive contract had been directed.[70]

The A.F. of L.-C.I.O. feud has carried over in even more aggravated form into other aspects of the Board's work. Under the Act the employer has a duty to bargain collectively with the representatives of his employees. But the determination of employee representatives involves a prior decision fixing the appropriate unit of representation or bargaining. And the power to fix the appropriate bargaining unit is the power to give direction to the labor movement by adjusting the claims of its rival factions.

Under the Act the Board must decide in each case whether the appropriate bargaining unit shall be the employer unit, craft unit, plant unit, or subdivision thereof. In carrying out this broad mandate, the Board has refused to commit itself to any simple formula. It has declared that it will consider the history of collective bargaining (if any) in the plant or industry, the mutual interests of the employees, conflicts of interest among employees, the functional coherence of the various operations of the plant, the geographical location of different units of the business, and other relevant factors.

The principles which the Board has utilized in settling disputes be-

[70] See *International Association of Machinists, Tool and Die Makers Lodge No. 35* v. *NLRB*, 9 U.S. Law Week 4006.

In an earlier case, *Consolidated Edison et al.* v. *NLRB*, 305 U.S. 197 (1938), where the NLRB invalidated a contract with an A.F. of L. union not involving a closed shop, the Supreme Court upheld the Board in ordering the company to desist from its unfair labor practices, but refused to declare the contract with the A.F. of L. invalid, on the ground (1) that the A.F. of L. union had not been properly notified by the Board that the legality of the contract was in issue and (2) that there was nothing in the contract itself which offended the Act since as yet a representative of the majority of employees had not been chosen. Justices Black and Reed dissented.

tween craft and industrial unions can be briefly summarized.[71] Where a craft union with a substantial membership in a group of employees claims jurisdiction, and there are no other conflicting claims, the Board always rules that a craft unit is appropriate. In cases in which a craft union claims a craft unit is appropriate and a rival union claims a larger unit, the Board in the past has applied what is known as the Globe doctrine.[72] Under the Globe doctrine the employees in the craft group decided for themselves whether they desired a craft unit or whether they preferred to be part of a larger unit including the craft group. If a majority of the craft unit expressed their preference for a craft union, then the Board held the craft unit to be appropriate; on the other hand, if they preferred the union claiming the larger unit, then the Board included the craft employees in the larger unit. This doctrine was recently qualified in the *American Can Company* case [73] where a majority composed of Leiserson and Smith with Chairman Madden dissenting held that the Globe doctrine should not be applied where an industrial union had first obtained an exclusive bargaining contract and had a record of continuity of bargaining relationships in the plant.

The decisions of the Board provoked criticism from many quarters. The A.F. of L. contended that the Board was dominated by the

[71] The common assumption that the A.F of L. invariably requests craft unions is not borne out by the facts. Up to March 1, 1939, A.F. of L. unions requested some form of industrial unit in approximately 210 cases, and a craft form in about 100 cases. During the same period, moreover, the C.I.O. occasionally asked for a unit smaller than that requested by the A.F. of L.

Nor is the common assumption accurate that the Board always decides cases in favor of the C.I.O. According to the minority report of the Smith Committee (page 29):

"The record shows that the Board up to December 1, 1939 had decided 301 cases in which the A.F. of L. and C.I O. were concerned over the appropriate bargaining unit. In 187 of these cases there was an agreement between the two organizations on the unit with complete agreement in 131 of the 187 cases and substantial agreement in 56 of the 187 cases. In 114 of this total of 301 cases there was complete disagreement between the A.F. of L. and the C.I.O. In these 114 cases the contention of the A.F. of L. was upheld in 51, the contention of the C.I.O. was upheld in 45. In 14 cases the contention of each was upheld in part and no decision was rendered in the other two cases. Prior to December 1, 1939, the Board had handled a total of 8,153 representation cases and had conducted 2,543 elections."

[72] So called from the case in which it was first used, the *Globe Machine and Stamping Co.,* 3 NLRB 294 (1937). This doctrine is written into the New York Labor Relations Act, which provides in express language "that in any case where the majority of employees of a particular craft shall so decide the board shall designate such craft as a unit appropriate for the purpose of collective bargaining."

[73] 13 NLRB 1252 (1939).

C.I.O.[74] and proposed, first, that the Act be amended to prevent the Board from abrogating contracts between unions and employers because of alleged unfair practices, and, second, that craft unions be made mandatory in all cases where craft membership existed. The C.I.O. contended that the Board had bent backwards to be fair to the A.F. of L. and demanded that safeguards be provided to prevent industrial unions from being carved up by craft groups.

Employer criticism was vociferous and was directed both against the Act and its administration. The most general criticism of the Act was its alleged one-sidedness—that it imposed restrictions on employers but failed to impose comparable restrictions on labor. Consequently, amendments were advocated: first, to impose curbs or restraints on labor; second, to increase the privileges of the employer under the Act; and, third, to "judicialize" the procedure of the Board itself. Of the proposals which would impose curbs on labor, the most persistent was one which would prohibit "coercion from any source" in employee self-organization. It was pointed out by labor representatives that the term "coercion" was left undefined and might be interpreted by an unfriendly Board to restrict many union activities which were previously deemed legitimate. Other proposals were more specific. Some would suspend the privileges of the Act for labor in the event of the breach of a collective bargaining agreement or of a strike not approved by a majority of employees in the appropriate unit. Others would require unions to register, submit financial statements, prevent unions from having alien officers, prevent political contributions by unions, and impose other comparable restrictions.

The second group of proposals, which were designed to increase the privileges of the employer in his labor relations, would prevent interference with the employer's liberty to express his opinion of unions to his employees and would enable him to enter into contracts with organizations of his own choice without Board restrictions. The third group of proposals took as their point of departure dissatisfaction with the organization and procedure of the Board. Some would abolish the present Board and replace it with new personnel; others would broaden the scope of judicial review over Board actions; still others would separate the Board's prosecuting and adjudicating func-

[74] A decision frequently cited in support of this contention is *In the Matter of Shipowners' Association of the Pacific Coast,* 7 NLRB 1002, where the C.I.O. Longshoremen Union was designated as the bargaining representative for all West Coast ports, though the A.F. of L. union claimed a majority among particular employers.

tions by providing for a Labor Relations Commissioner to investigate and prosecute and for a separate Labor Appeals Board to adjudicate.

Defenders of the Board pointed out that its administrative record deserved to be evaluated in terms of the purposes which Congress had in mind in creating it. Congress had created the Board to protect the legal right of workers to organize free from employer interference. This function the Board had discharged. If in some instances the zeal of Board employees had outrun their judgment and they had taken upon themselves direct organizing responsibilities which might more properly be left to the labor unions themselves it could not be said that such activity was characteristic of the Board's record as a whole. Nor could the Board be blamed for the A.F. of L.-C.I.O. feud. The Board did not cause that feud—it inherited it; and it inherited it without any specific mandate from Congress as to how to deal with it. In the face of extremely difficult circumstances, it had not pleased either side completely, though it had tried to be fair and impartial. Nor could the Board be blamed because an era of industrial peace was not yet upon us. The NLRB had no general power to mediate, conciliate, or arbitrate labor disputes; its sole function was to protect the right of workers to organize. If employers chose to resist organization and employees chose to strike in retaliation, there was nothing in the Act to prevent such industrial disturbances. Yet, pointed out Board protagonists, it was not without significance that there had been a notable decrease in strikes after the Supreme Court declared the Act constitutional and the administrative remedies of the Act became available to labor.[75]

After 1938 the Board was subjected to increasingly severe attack. With the resurgence of conservative strength which first became evident in the 1938 elections and the deepening cleavage between the

[75] Note the evidence adduced by Congressman Healey: "In 1938 there was a decrease from 1937, of 42 per cent in the number of workers involved, and of 68 per cent in the total man-days of idleness due to strikes. In the first ten months of 1939 it declined to 40 per cent of the total for the same period of 1937. The same trend continued in November and December of 1939, despite the fact that during these years the number of men organized into unions was about three times as great as in the pre-1935 period, and despite a rising trend of business activity during the greater part of 1939. And while the number of strikes was greater in 1938 and 1939 than in 1935 and 1936, their severity diminished, since the number of workers involved and man-days lost was less in 1938 than in any year since 1932 and 1931, respectively. Similarly, since the validation of the act the number of sit-down strikes declined from a high of 170 in March, 1937, to only six in the entire year 1939." See 86 *Congressional Record* 11791 (1940).

A.F. of L. and the C.I.O., the position of the Board was considerably weakened. In 1939 the House of Representatives authorized an investigation of the Board by a committee dominated by a majority hostile to the Board. In 1940 the amendments to the National Labor Relations Act sponsored by this committee passed the House by the overwhelming vote of 258 to 129,[76] though friends of the Board were still strong enough to prevent action in the Senate. Meanwhile, however, the first chairman of the Board, J. Warren Madden, was not reappointed because it seemed unlikely that his appointment would be confirmed by the Senate. Extensive changes were made in the organization and procedure of the Board in the effort to placate opposition.[77] As this is written, its future still remains obscure, though the readjustments in personnel and procedure which have been effected appear to have warded off the possibility of extinction.

WAGES-HOURS LEGISLATION

The collapse of NRA in 1935 dealt a serious blow to attempted federal regulation of hours, wages, and working conditions. In 1936 a fresh start was made through the Walsh-Healey Act. Unlike its more ambitious predecessor, this statute rests the authority to regulate, not on the interstate commerce clause, but on the power of the government as purchaser to insist upon stated contractual conditions.[78]

The Act requires that all federal contracts involving $10,000 or more must contain provisions that no individual employed in connection with such contracts shall work more than eight hours per day or forty hours per week, except as permitted by the Secretary; [79] that

[76] The majority of the Smith Committee (so called after its chairman, Howard W. Smith) effected a coalition with the A.F. of L. forces in Congress. The amendments as finally voted contained protections for A.F of L. craft unions, as well as provisions increasing the privileges of employers and restricting the scope of Board activity. The Smith Committee amendments also proposed the separation of administrative and judicial functions by vesting all administrative duties in a Labor Relations Administrator, independent of the Board.

[77] See footnote 62, p. 178.

[78] In *Perkins* v. *Lukens Steel Co.,* 310 U.S. 113 (1940), the Supreme Court dismissed an injunction granted by the Court of Appeals of the District of Columbia restraining government officials from applying a wage determination of the Secretary of Labor for the iron and steel industry. The Court held that the complaining companies lacked standing to sue.

[79] The Secretary has authorized work in excess of the stated minima, if compensated for at the rate of time and one half.

convict labor will not be used; that boys under sixteen and girls under eighteen will not be employed; that safety and sanitary standards will be observed; and that all persons employed by the contractor will be paid not less than the prevailing minimum wage of the industry as determined by the Secretary of Labor. The Division of Public Contracts, headed by an Administrator responsible to the Secretary of Labor, enforces the Act. The Public Contracts Board of the Division of Public Contracts recommends the prevailing minimum wage for an industry. The final determination is issued by the Secretary of Labor. The Act provides no criminal sanctions. Violators of the Act face a choice between restitution and black-listing. The latter penalty, which involves the drastic sanction of withholding government business from the offending contractor for a three-year period, has rarely been used. According to a recent study:

> In the something over three years that this statute has been in effect some 16,500 separate contracts have been negotiated subject to its terms. They have involved a total of approximately $1,189,936,000. It is estimated that the working conditions of 2,000,000 employees of 9,000 employers have been directly affected. During this period 30-odd wage determinations were made by the Secretary, relating to industries of such dissimilar character as the commercial fireworks industry, the drug manufacturing industry, and the men's cap and hat industry. Thus, it may be seen, the regulative force of the law may not be inconsiderable.[80]

With the vast increase in the tempo of national defense expenditures, these regulative potentialities are likely to increase in scope.[81]

The Fair Labor Standards Act of 1938 (more popularly known as the Wage and Hour Law) has a considerably wider coverage than the Walsh-Healey Act. As of April, 1939, it was estimated that approximately 12,500,000 employees were subject to the Act. The main provisions of the Act can be briefly summarized. The Act sets fairly rigid hour standards; for the first year after passage the maximum work week was 44 hours, for the second year 42 hours; henceforth it is to be 40 hours. The law, however, does not prohibit employment in

[80] See Attorney General's Committee on Administrative Procedure, *The Walsh-Healey Act, Monograph* No. 1 (1939), p. 3.

[81] Congress has been careful to incorporate into emergency legislation provisions that the Walsh-Healey Act be observed by defense contractors. The President, however, is given authority to suspend the Act in the interest of national defense. Where the eight-hour day limit has been relaxed, time and a half for overtime has been required. See 3 *Wage and Hour Reporter*, pp. 499–500.

excess of 40 hours, provided overtime is paid at one and a half times the regular rate. The ultimate goal to be reached in 1945 is a 40 cents an hour minimum wage. For the first year, a minimum of 25 cents an hour was prescribed. For the next six years, from October 24, 1939, to October 24, 1945, the minimum wage is to be 30 cents an hour unless in the interim a higher wage, not exceeding 40 cents an hour, is fixed for a particular industry on the recommendation of a committee representing employers and employees of that industry and the general public.

The Act provides for numerous exemptions, some outright, others dependent on administrative regulation. Child labor under sixteen years of age is prohibited except under special conditions laid down by the Chief of the Children's Bureau. The age limit may be raised to eighteen years, in such occupations as the Children's Bureau finds hazardous or peculiarly detrimental to health and well-being. The enforcement of the Act is vested in a single administrator heading a Wage and Hour Division in the Department of Labor. Criminal as well as injunction proceedings may be instituted against violators; employees may also bring suit for recovery of double damages.

Within a few weeks after the passage of the Fair Labor Standards Act, the Wage and Hour Division received more than one hundred thousand inquiries from employers and employees raising questions with reference to the coverage intended by Congress and other questions of interpretation of specific provisions of the law. An interesting administrative device emerged as the result of this flood of inquiries. Beginning in November, 1938, the office of the General Counsel commenced the issuance of a series of interpretative bulletins. While these interpretative bulletins were, of course, not binding on the courts, they helped to clarify the meaning of the law to the general public; and they provided indications of the policy which served to guide the administrator and his staff in enforcing the law.[82]

[82] Particularly difficult were the problems of coverage. Under the law the wage and hour provisions do not apply to agricultural workers, seamen, employees of airlines, streetcars, motorbus, or urban railways, and employees of weekly or semiweekly newspapers with a circulation of less than 3,000, the major part of whose circulation is in the county of publication. They do not apply to persons employed in a bona fide executive, administrative, professional, or local retail capacity, or to outside salesmen. They do not apply to persons employed in any retail or service establishment, the greater part of whose selling and servicing is in intrastate commerce. They do not apply to persons employed to handle or prepare or can agricultural or horticultural products for market or to make dairy products in the area of production. In addition

One of the most interesting administrative features of the Wage and Hour Law is the provision for the creation of industry committees to recommend wage orders exceeding the statutory minimum. The Act requires that "the Administrator shall as soon as practicable appoint an industry committee for each industry engaged in commerce or in the production of goods for commerce." [83] The Administrator is required to designate as members of these committees an equal number of persons representing employers, employees, and the general public. After such a committee has completed its investigation it is required to recommend "the highest minimum wage rates for the industry which it determines, having due regard to economic and competitive conditions, will not substantially curtail employment in the industry." The industry committee is also authorized to recommend reasonable classifications within an industry, but in determining such classifications it may not fix wages solely on a regional basis. It is required, however, to consider:

(1) competitive conditions as affected by transportation, living, and production costs;

(2) the wages established for work of like or comparable character by collective labor agreements negotiated between employers and employees by representatives of their own choosing; and

(3) the wages paid for work of like or comparable character by employers who voluntarily maintain minimum wage standards in the industry.

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to these classes which are exempt from both the wage and hour provisions, there are still others, such as employees of railway, motorbus and truck carriers regulated by the Interstate Commerce Commission, who are exempt only from the hour provisions. And there are still others, such as employees in seasonal industries and employees who are working under annual or semiannual guaranteed wage plans which have been negotiated through collective bargaining, who are partially exempt from the hour provisions. In addition, there is another whole class of exemptions, which admits the payment of a subminimum wage to learners, apprentices, and individuals whose earning capacity is impaired by age or physical or mental deficiency or injury.

Merely to list these exempted classes is perhaps to suggest some of the complexities of this problem of interpreting coverage. When are employees engaged in the production of goods for intrastate commerce? How define "retail or service establishment, the greater part of whose selling is in intrastate commerce"? How define executive and administrative workers? Learners and apprentices? Seasonal workers? Agricultural processors? Area of production? The difficulties are manifest, and the litigation which has already been initiated promises judicial as well as administrative interpretation to fill in the interstices of a loosely knit legislative fabric.

[83] Requests to appoint such committees have already been received from over one hundred industries.

These recommendations are then submitted to the Administrator. After a hearing, he may reject or accept them. In the latter case a wage order is issued putting the recommendations into effect. Up to October 19, 1940, eleven industry committees had made recommendations for payment of higher than the 30 cents an hour minimum prescribed by the law. These industries covered some 2,135,000 workers in clothing, textiles, apparel, leather, and paper. Some 537,000 persons received wage increases as a result of these recommendations.[84]

It is still too early to hazard any final judgment on the effectiveness of the Wage and Hour Law. Its constitutionality has been upheld by the Supreme Court.[85] But enforcement must still be considered to be in its organizational stages.

The Wage and Hour Division found itself faced at the outset with a large volume of complaints, an insufficient budget, and a handful of partially trained inspectors. In January, 1939, the total personnel of the Wage and Hour Division numbered 488, of whom 113 were in the field. This small staff made any really satisfactory system of inspection almost impossible. To enforce the New York State Minimum Wage Law, Administrator Andrews had had over 360 inspectors, one to every 2,500 employees covered. As New York State Industrial Commissioner, he presided over a staff of 7,200; as Administrator of the Wage and Hour Law, his inspection staff was reduced to a mere handful. Under the circumstances, it was impossible to investigate one tenth of the complaints that came in, and the Division necessarily had to concentrate on those complaints which alleged especially flagrant violations. Much of the labor dissatisfaction with the Act dated from those early administrative inadequacies. In attempting to enforce the Act, the Wage and Hour Division had to rely largely on outside groups and individuals to do the policing. The largest proportion of the complaints, as might be expected, came from labor unions or employees, though in bitterly competitive industries such as clothing, employer complaints were also important.

[84] See New York *Times*, October 19, 1940.

[85] *U.S.* v. *Darby Lumber Co.*, 9 U.S. Law Week 4170 (1941). See also *Opp Cotton Mills* v. *Administrator of the Wage and Hour Division of the Department of Labor*, 9 U.S. Law Week 4174 (1941). In the latter case the Supreme Court upheld the validity of the Administrator's order fixing a 32½ cents minimum hourly wage for the textile industry on the basis of an industry committee recommendation. The Court rejected arguments that the Act was an unconstitutional delegation of the legislative power of Congress and that the procedure employed by the industry committee and the Administrator was not in accordance with the requirements of due process.

The object of the Wage and Hour Division has been to avoid litigation wherever possible and to invoke the criminal penalties of the Act only in the most flagrant cases. Where violations have been minor and unintentional, the Division has followed the practice of accepting settlements providing for future compliance and restitution of any back wages which may be due.[86] In adopting the policy of making haste slowly, the Division has viewed its problem as still largely one of education. Whether a more vigorous program of enforcement will become necessary remains to be determined by further experience with the Act.

THE EMERGING PATTERN OF INDUSTRIAL RELATIONS

The development of public policy in recent years has been directed toward raising standards of wages, hours, and working conditions and safeguarding labor's right to organize for collective bargaining purposes. In this respect, the United States has been following a pattern already marked out earlier in many other industrial nations. The result, both here and abroad, has been a considerable growth in the strength of organized labor and a rapid increase in the number and coverage of written collective agreements. While employers have frequently viewed these developments with foreboding at their inception, experience in Great Britain, Sweden, and elsewhere seems to indicate that as trade-unions attain stability of organization opposition to collective bargaining disappears, and there develops "a real determination upon the part of national officers and individual members of the employers' organizations and of the trade-unions to employ to the full the system of voluntary national agreements and to make these function as effectively as possible." [87] The promotion of harmonious industrial relations places a heavy burden of responsibility on employers, employees, and government. Whether this responsibility is discharged effectively depends in no small measure on whether the parties affected can demonstrate "patience, understanding, and a desire to make and keep agreements and to achieve industrial peace." [88]

[86] Figures issued by Administrator Fleming late in 1940 indicated that restitution of more than $6,000,000 had been assured to employees and that more than $4,500,000 had already been paid. See New York *Times,* October 19, 1940.

[87] *Report of the Commission on Industrial Relations in Great Britain* (1938), p. 24.

[88] *Ibid.*

Chapter Seven. GOVERNMENT, THE CONSUMER, AND THE PUBLIC INTEREST

Of all basic economic interests in modern society that of the ultimate consumer is the broadest, the most akin to a general interest, and yet the least organized, the least articulate, and the least recognized in the dynamics of policy formation. For the consumption of a particular individual is spread over a wide variety of commodities, while each commodity is consumed by a host of individuals. Large institutional consumers, and producers purchasing raw or semimanufactured materials for further fabrication, stand on a different footing. They combine a powerful interest in particular commodities with resources adequate to promote and protect that interest. The position of the ultimate consumer, however, is inherently weak, since his interest is ordinarily too diverse and too widely diffused to lend itself readily to effective organization.

In the theoretical system of classical economics, the consumer played a sovereign role. Adam Smith succinctly stated the concept in an oft-repeated remark concluding his discussion of mercantilism. "Consumption," he wrote, "is the sole end and purpose of all production; and the interest of the producer ought to be attended to only so far as it may be necessary for promoting that of the consumer. The maxim is so perfectly self-evident, that it would be absurd to attempt to prove it." [1] As the end result of the economic process, so ran the theory, consumption is the basic motivation of economic activity in an individualistic order. It not only provides the spur to profit seeking, which is, in turn, the motive force maintaining system equilibrium;

[1] Adam Smith, *The Wealth of Nations,* Cannan ed., Vol. II, p. 159.

it is also the incentive for laborers, landowners, and investors in pursuing their appropriate functions within the whole.

The classical theory validly emphasizes the vital function of consumption in the economic process. The actual position of the ultimate consumer in economic life, however, is far from sovereign. Modern technological development, resulting in a multiplicity of similar products, tends to widen the gap between economic theory and actuality. Rational consumer choice among commodities becomes more difficult as the range of choice broadens. And, to increase this difficulty, much of the expanding volume of advertising is directed to creation of demand, often by specious differentiation of branded products, rather than to guiding consumers toward the most effective satisfaction of pre-existent demand.

As other major economic interests—business, agriculture, and labor—organized to strengthen their influence in the market and enlist the power of government in their behalf, a movement has slowly gathered force for counterorganization by consumers as such. Organization has had to face the serious obstacles presented by the very nature of the consumer interest. Nonetheless, it has begun to play a significant part in recent years in shaping government's role in the economic order. In this process three elements stand out. A specific consumers' interest is being differentiated and organized in a variety of forms. It is, in turn, reflected in government in two ways: (1) the elaboration of protective consumer legislation and (2) the representation of consumers' interest through special administrative agencies.

1. The Nature and Organization of the Consumers' Interest

It is often asserted that consumers' interest is identical with public interest and that it consequently requires neither special organization nor special representation in government. In the formation of the National Recovery Administration, for example, General Johnson took this view, asserting that a consumers' advisory board was superfluous in view of the protection of the public interest by himself as Administrator and by the President. The consumers' interest is, of course, generally shared since consumption is universal. It is a horizontal rather than a vertical category, affecting everyone while he performs a consuming function. For any individual it may be secondary to his interest in a productive or other capacity. Viewed most broadly, consumers' interest approaches general public economic interest in bene-

fiting from a larger and better distributed national income. It may, however, conflict on occasion with other functional interests. Consumer interest as such, for example, will presumably always favor low prices, whatever the cost in substandard working conditions or in economic dislocation. Moreover, the consumers' interest in particular commodities may conflict with other elements of the public interest as a whole.

In a narrower sense, consumers share a common interest, once in possession of a given amount of income, in the most efficient conversion of their income into goods and services. To this end, they require accurate information concerning available commodities: facts on variety, on quantity, on quality, and on prices. They share an interest in defense from misrepresentation and injury. Finally, although purchasers benefit from any improvement in productive or distributive efficiency which is passed on to them, their immediate relation to the retail market gives them a special interest in improved distributive efficiency.

The degree of the consumers' interest in particular commodities is ordinarily very small, too small to serve as a basis for effective organization. Even the slightest increase in income will ordinarily improve an individual's position more substantially than price reduction on any one commodity which he consumes. Only if organization can improve his status with regard to a wide range of consumed goods and services can he afford to contribute to the cost of such organization or protection. Institutional consumers buying in large quantities constitute a marked and important exception to this generalization. As the area of free governmental services broadens, political units, whether local, state, or federal, perform an increasing share of the purchasing function on behalf of their constituents. Systematic testing and formulation of rigid specifications are highly developed for such consumers. Such tests are employed not only by political units, but also by educational and charitable institutions and by business concerns purchasing capital equipment and raw or semimanufactured materials. The purchasing agent's vocation has become a veritable profession, involving the establishment of standards and the development of scientific techniques for testing the conformity of purchased commodities with such standards.

Consumers' interests are often so closely related to those of better organized groups that they may be promoted in conjunction. Farmers, for example, share with consumers of farm products an interest

in efficient distribution and reduction in price spread between the raw commodity and the retail market. Increased consumption is sometimes the most promising means of improving the farmer's position. Created primarily to promote producing interests, farm organizations also seek protection for the agricultural community as a leading consumer of manufactured goods. It is significant that the oldest and best-established consumer service agency in the federal government is the Bureau of Home Economics in the Department of Agriculture, which acquired its present status in 1923. Producers supplied the initial impetus to meat inspection, grain standardization, and compulsory government grading of agricultural commodities; these programs redound to general consumers' advantage as much as to their own. That the interests of consumers and of farmers as producers often conflict, on the other hand, hardly needs illustration.

Organized labor groups sometimes play an active role in their capacity as consumers, particularly in connection with large items like housing. In addition, business concerns of superior efficiency are often allied with consumers' interests, in an effort to capture a larger share of the market through improved service or lower prices. It is, of course, the operation of the "unseen hand" of competition through this process which was supposed by classical economic theorists to identify the private self-interest of entrepreneurs with the general interest of consumers. On the contemporary political scene, consumer groups and large distributors have allied themselves in opposition to discriminatory legislation designed to freeze the channels of distribution. The occasional identification of consumers' interest with other and better organized interests, however, does not eliminate the frequent conflicts. The "unseen hand" shows signs of paralysis over ever-widening areas. In response to this situation, a small but growing movement has arisen to organize the interest of consumers as such.

THE CONSUMER MOVEMENT

The oldest and most powerful element in consumer organization is the co-operative movement. Originating in Rochdale, England, in 1844, European consumers' co-operatives now occupy an important position both economically and politically. The Rochdale type, which sets the pattern for the great majority, obtains its capital from members on the basis of a fixed return. Each member is given one vote regardless of the amount of capital contributed. Surplus earnings

are returned to purchasers in proportion to the volume of their purchases. Salaried managers are responsible to the consumer-owners. Co-operatives thus eliminate by their very constitution the conflict of interest between consumers on the one hand and profit making on the other. Beginning in the retail field, they have confederated into large-scale wholesale co-operatives and for some commodities have even undertaken manufacturing operations.

Consumers' co-operatives in 1939 handled from 10 to 12 per cent of the retail business in Great Britain, Sweden, and Switzerland, and almost 30 per cent in Finland. They also played an important political role, usually allying themselves with trade-unions as constituents of labor or social democratic parties. American co-operative experience has been far more limited. Although sporadic efforts were made to establish the movement ever since the original Rochdale experiment, the majority were utopian ventures in a new way of life rather than soundly organized economic enterprises. The psychology of boom periods was alien to their growth; depressions frequently meant their bankruptcy.

In the last quarter century, however, a more stable co-operative movement has developed, centered at first around Finnish or Scandinavian groups. Headway became pronounced after the depression of 1929. Ten years later, it was estimated that 4,350 retail co-operatives, with a membership of about 925,000, were doing an annual business of $210,000,000. There were also 914 miscellaneous service co-operatives, the majority distributing electric power.[2] Twenty-three regional wholesale associations handled consumer goods, nineteen of them organized into two large co-operative unions, United Co-operatives and National Co-operatives. The movement since 1916 has been represented by the Co-operative League of the United States, which publishes a journal, exchanges information, and performs the general functions of a trade association. Groceries, petroleum products, fuel, and electricity are the major commodities handled co-operatively.

A parallel type of organization, the credit union, which was first promoted in the United States before the war, has also grown very rapidly since the depression. It provides consumers' credit almost

[2] In addition, some 5,000 associations supplied telephone service in isolated areas to subscribers on a co-operative basis. These organizations hold themselves aloof from other co-operatives and cannot be viewed as integral elements of the consumers' movement.

wholly from funds within the union itself. Loans are made at interest rates from 4 to 12 per cent, relatively low figures for credit of this type. From 400 in 1929, the number of credit unions has increased to 8,315 in 1939, with 2,421,000 members and an annual business of over $240,000,000. Their organization was aided by passage of a Federal Credit Union Act in 1934, providing for federal charter and supervision through the Farm Credit Administration. Insurance for almost 7,000,000 policyholders was also carried by 1,800 consumers' co-operatives.

The consumers' co-operative movement must be distinguished from the firmly established agricultural producers' co-operatives, which have been an important feature of the American economy for many decades. These organizations provide groups of farmers on a nonprofit basis with common services which are too expensive or elaborate to be undertaken by individuals. They engage in the processing and marketing of farm products and in large-scale purchasing of farm machinery, fertilizer, and other producers' goods. In part, they overlap with consumers' co-operatives, since they often extend their purchasing activities into the field of ultimate consumers' goods as well. Their major interest, however, is in production. When engaged in marketing activities, their interests may conflict with those of consumers in precisely the same manner as other producers' organizations.

Farm co-operatives have been given a privileged political status through special credit facilities, tax remissions, state and federal, and other aids. Consumers' co-operatives are similarly favored only in a few jurisdictions. Wisconsin alone exempts retail co-operatives from state income taxes; credit unions are exempt in six states. Rural electrification co-operatives are favored by assistance from the Rural Electrification Administration and are included along with public agencies under the "preference" clause in federal public power legislation. By and large, however, consumers' co-operatives are given no special advantages and must make their way in the economy on their own merits. That they are able to do so is amply demonstrated by European experience. The elaboration of their organization and continued growth of their business operations since 1929 suggest that the recent upsurge will prove an exception to the ephemeral character of previous phases of co-operative activity. Although still doing only an insignificant portion of the nation's total retail business consumers' co-operatives form a solid nucleus for wider consumer or-

ganization based on the satisfaction of immediate economic needs.

Aside from co-operatives, the only organizations performing direct services on behalf of the ultimate consumer as such are research and testing groups. As yet operating on only a very small scale, they seek to afford a rational basis for consumer choice in the jungle of brand names and high-pressure advertising techniques. Only in this way, they argue, can the ultimate consumer match the position of the institutional purchaser, who acts on the basis of specifications, quality tests, and careful price comparisons.

The pattern for their operations was set by Consumers' Research, Inc. It was established in 1929 after publication of *Your Money's Worth,* a best-selling book by Stuart Chase and F. J. Schlink, which evoked enormous public interest in consumer protection. A rival organization, the Consumers' Union of the United States, was founded in 1936 by striking employees of Consumers' Research. A third and smaller group, founded on similar lines and operating in Denver, was set up in 1932 under the name Intermountain Consumers' Service. Aggregate membership in 1940 was estimated at about 150,000. All three agencies are nonprofit making and are supported by membership fees and the sale of publications. Tests are made on commodity samples purchased in the open market.

Existing organizations of this type are hampered to some extent by limited funds and by the intrinsic difficulties of satisfactory testing for certain commodities. They have had to compete, moreover, with various spurious imitations, some of which are pure frauds classifying commodities without any scientific testing, while others accept subsidies for sponsoring the wares of particular manufacturers. The Federal Trade Commission has issued cease and desist orders against a number of these self-styled "testing bureaus."

On balance, the research and testing organizations have been favorably appraised by observers of the consumer movement.

In spite of whatever limitations they may have from the general economic and social point of view [writes one] they have unquestionably offered to the consumer a degree of protection to pocket-book and health which far outweighs particular cases of error; and consumers have found that these economic comparisons are as interesting to them as is the competitive game to businessmen.[3]

[3] H. Sorenson, "An Economic Interpretation of the Consumer Movement," unpublished doctoral dissertation at Radcliffe College, 1940, p. 110. A revised version of this work will appear shortly in published form under the name *The Consumer Movement.*

Consumers' Union allies itself affirmatively with other elements of the consumer movement, particularly consumers' co-operation. Intermountain takes a neutral stand, while Consumers' Research is paradoxically positively hostile. In any case, their work stimulates consumer consciousness. They popularize knowledge of government protective activities and at the same time give life to the widespread, dormant suspicion that further protection is badly needed.

The consumer movement also manifests itself in organizations devoted to general discussion and promotion of consumer welfare, usually as part of a broader program. Home economics teaching provides a focus for organization of the consumers' interest in the educational field. In addition, the concentration of the purchasing function in their hands gives to organized women's groups a special interest in consumer welfare. The General Federation of Women's Clubs, the American Association of University Women, the League of Women Voters, and other similar organizations in lesser degree, give prominent place to this topic among their avowed purposes. Several of the leading women's organizations maintain contact with governmental developments through the Women's Joint Congressional Committee. While not to be compared in strength with the large agricultural or labor organizations, the "women's lobby" is a not inconsiderable force in the legislative process. The medical profession has also given some attention to consumer protection against fraudulent and dangerous proprietary medicines. Through Better Business Bureaus, merchants likewise seek to eliminate the cruder forms of consumer deception.

For all the ferment in the consumer movement in recent years, independent organization of this interest continues weak and is likely to remain so. Only with assistance from government does it promise to play a part in the balance of social forces commensurate with its objective significance.

2. Protective Legislation for the Consumer

Almost every form of government action has some effect on consumer welfare, adverse or favorable. Consideration of consumers' interests played a leading role in the growth of public utility regulation and a significant part in the development of antitrust policy. Public enterprise is likewise often undertaken in response to particular consumer needs. The traditional identification of consumers'

interest with public interest makes the former a touchstone for appraisal of governmental action. In the absence of effective organization, however, it is often disregarded in the formulation of public policy. Its struggle for recognition against well-knit producers' organizations, despite the latter's inferiority in numbers, is always a difficult one. Notwithstanding this weakness, occasional waves of popular indignation, and the more frequent cases of identity of interest between consumers in general and agricultural or other, better organized groups, have brought about several forms of special government protection for the consumer. Chief among them are measures, such as the pure food and drug laws, to prevent adulteration and misbranding. Parallel legislation against false advertising is a more recent development. In the last few years, the growing consumer movement, supported by some producers, has demanded amplification of such regulations with particular regard to quality standards.

LEGISLATION FOR PURE FOOD, DRUGS, AND COSMETICS

General principles of commercial law give to the buyer some degree of protection against adulteration or misrepresentation. His legal relations with sellers no longer accord with the rule of *caveat emptor*. The doctrine of "breach of warranty" affords remedies for misrepresentation which can be extended behind the retailer as far back as the manufacturer. Fraud lays the seller open to criminal as well as civil action. Damages may be collected for injury or death consequent upon a seller's negligence. Except for his rare purchases of expensive, durable consumers' goods, such as houses or automobiles, however, or cases of serious injury with heavy damage claims in the balance, such legal protection without administrative enforcement is of no avail to the ultimate consumer. A multitude of fraudulent misrepresentations will bilk the entire consuming public of many fortunes without costing any single individual enough to repay a lawsuit. When adulteration is injurious to health or life, moreover, administrative prevention is far more desirable than legal remedy.

State and local provisions of one sort or another against the more glaring instances of adulteration or fraud have a very long history. Sanitary regulations, inspection of weights and measures, and the like, were viewed as normal public functions at the beginning of the nineteenth century. Relative local self-sufficiency, particularly in foods, made this form of regulation reasonably adequate to the protection of the public. With the development of mass production in

foodstuffs and the elaboration of processing techniques in the second half of the century, the needs of protection became more complex. State-wide legislation against adulteration of foods and drugs began with Virginia in 1848 and Ohio in 1853. It spread during the remainder of the century over the larger part of the nation. More recently, a modicum of protection against false advertising has been obtained through enactment by many states of the model statute sponsored by the advertising trade journal *Printers' Ink*. The increasing proportion of interstate to intrastate commerce, however, made federal supplementation of state protection essential. As with protective labor legislation, interstate competition prevented any single jurisdiction from raising its standards very far out of line with the others. The struggle for a federal law began about 1880 and required a full quarter century before its ultimate victory.

The Pure Food and Drug Act of 1906 was adopted by Congress only after an accumulation of public concern regarding food adulteration and patent medicine frauds over several decades. General pure food bills had been introduced as far back as 1890 but were always lost somewhere along the legislative road. Constitutional considerations, particularly among the Southern Democrats, played some part in the opposition. Its core, however, was the powerfully organized lobby of the Proprietary Association of America, backed up by many of the large business interests which exercised a dominating influence over the Congressional leadership of that period. Only through a slow process of public education, accelerated in the first few years of the twentieth century by a flood of popular writings describing existing evils, did positive action finally become unavoidable.

The educational process was led by Dr. Harvey W. Wiley, chief chemist of the Department of Agriculture from 1883 to 1912, who organized the famous "poison squad" of Department employees for the testing of food preparations. Professor E. F. Ladd, Food Commissioner of North Dakota, made similar experiments with even more sensational results. Public excitement and irresistible demand for Congressional action came only with the wide publicity given to such investigations by the "muckrakers." Magazine articles by the dozen, together with several popular books, devoted themselves to this topic. Climaxing the entire movement was the publication early in 1906 of Upton Sinclair's *The Jungle,* dealing with the Chicago stockyards. An immediate best seller, its descriptions of slaughtering practices were so shocking that sales of meat were heavily reduced.

President Theodore Roosevelt took up the cudgels for Wiley's Food and Drug Bill. It was finally passed with only a few opposing votes, although its contents were substantially watered down from the original form. Under the influence of *The Jungle,* public meat inspection, which had been applied to the export market in 1890, was now extended to the domestic market.

Protection of the consumer's purse as well as his health was sought by the Act of 1906. It forbade the delivery or receipt in interstate commerce of adulterated or misbranded foods and drugs. Misbranding was defined as (1) being affirmatively "false or misleading in any particular," (2) failing to state the quantity of ten enumerated habit-forming or dangerous drugs, or (3) being in imitation of another article. Adulteration of food included (1) substitution of less valuable constituents, (2) abstraction of valuable constituents, (3) hiding of damage or inferiority through artificial coloring or coating, (4) addition of poisonous or other deleterious ingredients possibly injurious to health, and (5) inclusion of decomposed or diseased animal or vegetable substance. Drugs were required to conform with standards established in the semiofficial United States Pharmacopoeia and National Formulary, or else to have their standard of quality stated on the label. Detailed regulations were made by the Treasury, Agriculture, and Commerce Departments jointly, but actual administration was placed in the Department of Agriculture because of Dr. Wiley's earlier work.

Criminal prosecution was the major sanction, with a fine up to $200 for a first offense and $300 or a year's imprisonment for subsequent offenses. Adulterated or misbranded articles also became subject to forfeiture upon their entry into interstate commerce. The latter was a more rapid remedy, essential to prevention of public injury from poisoned substances after they had begun their journey in the stream of commerce. Federal legislation was followed by revision of food and drug laws in almost every state, generally bringing the definitions into accord with the federal model. In states providing for effective administration, these laws were an important supplement to federal action, since they could attack directly the manufacture and sale of the forbidden goods within their jurisdictions.

On the whole, the Food and Drug Act provided reasonably effective protection against the excesses of dangerous adulteration. Its administration was hampered, however, by inadequate appropriations. In a number of critical instances, heavy pressures were brought

to bear upon rule-making officials to exercise their discretion in a manner lenient to manufacturers. The wave of popular feeling which had brought about enactment of the law left in its wake no organization to keep watch over effective enforcement. Dr. Wiley himself asserted that weakness in administrative action amounted to executive sabotage; after a bitter conflict with the Secretary of Agriculture and Presidents Roosevelt and Taft, he resigned in 1912.

Location of the Food and Drug Administration in the Department of Agriculture sometimes subjected it to demands from interests close to the center of the Department's work. Noteworthy examples were the rules regarding the use of corn sugar in canning and regulations for minimum tolerances of poisonous lead spray residues on fresh fruit. In the latter instance the steadily deteriorating economic situation of the fruit growers of the Pacific Northwest led to vigorous pleas for raising the tolerances. Successive revisions to this effect were made in 1933 and 1938.[4] On the whole, however, given its limited resources, the Administration through co-operation with the industry made great strides in eliminating dangerous products.

Protection against misbranding and economic protection against misrepresentation were less adequately covered by the Act. It made specific exceptions for proprietary foods sold under distinctive names, as long as they contained no added dangerous ingredients, and for compounds, imitations, or blends when plainly so labeled. The Courts, moreover, while friendly enough to broad interpretation of the adulteration provisions, took a different view with regard to misrepresentation. In 1911 the Supreme Court held that the words "false or misleading in any particular" did not include far-fetched declarations of therapeutic or curative effects.[5] The so-called Sherley amendment, designed to rectify this decision, was passed in the following year. The patent medicine interests were able in the course of its passage to transform its prohibition of "false and misleading representations" into one of "false and fraudulent representations." Since well-established principles of the law of fraud require knowledge and intent on the part of the malefactor, proof of this offense became practically impossible.

In addition, the remedies of the Act proved seriously weak. Juries

[4] Transfer of the Food and Drug Administration to the Federal Security Agency in 1940 has not wholly relieved it from such pressures. A further increase in lead residue tolerances was adopted at the end of that year.

[5] *United States* v. *Johnson*, 221 U.S. 488.

were often loath to convict local manufacturers. The fines, in any case, were very small. A number of hardened offenders came to look upon repeated fines simply as a license fee for continuing in business. Imprisonment was practically never imposed. Perhaps the outstanding defect of the law, however, was its failure to include advertising, which is far more influential than bottle labels in stimulating purchases. The Federal Trade Commission Act offered only a feeble degree of protection in this field.[6]

Except for the Sherley amendment and the Gould amendment of 1913, requiring quantity labels on packaged goods, modifications of the 1906 Act before 1938 were mostly sponsored by agricultural producers. A definitive standard for the term "butter" was adopted in 1923. The McNary-Mapes amendment of 1930 required the labeling as substandard of canned products falling below standards of quality, condition, and fill promulgated by the Secretary of Agriculture. No provision was made, however, for grading above the minimum.

With the resurgence of interest in consumer protection during the Great Depression, increasing attention was given to the defects of the basic Act. The Food and Drug Administration had for some years remonstrated against its limitations. Under its auspices, far-reaching revision of the entire legislative structure was prepared for introduction into the 73rd Congress in 1933. There followed a five-year battle royal between the proponents of increased consumer protection and affected manufacturing and advertising interests. Through advertising channels heavy pressure was brought to bear on the press, which with few exceptions joined the chorus of opposition. The measure seesawed back and forth between House, Senate, committees, and subcommittees, with weakening amendments of one sort or another being added at almost every stage. Controversy centered about the far-reaching discretionary authority given to the Secretary of Agriculture, provisions dealing with false advertising, power to establish multiple grading for food products, and the new definitions of adulteration and misbranding. In 1936 it appeared unlikely that any bill would pass.

At a crucial stage in the proceedings, however, almost one hundred persons were killed by the new drug "elixir sulfanilamide." The situation threatened a repetition of the popular feeling of 1906. Reputable manufacturers became hesitant to continue outright resistance to a

[6] See below, pp. 514–516.

bill of such widespread popular concern. The new Food, Drug, and Cosmetic Act, finally passed in June, 1938, contains numerous evidences of compromise but is a substantial advance over the old law. It expands the degree of consumer protection through enlargement of the range of affected commodities, broadened definitions of adulteration and misbranding, increased penalties, and special provisions for peculiarly dangerous substances. The more substantial modifications deal with misbranding, which was less adequately handled than adulteration under the old law. Cosmetics, except for soap, and therapeutic devices are included in its terms. Food adulteration is redefined to cover retention of natural poisons as well as addition of poisonous substances, subject to tolerances prescribed by the Secretary of Agriculture. In addition, substances may not be added to food to increase the bulk, reduce the quality or strength, or "make it appear better than it is." Coal-tar coloring products may be used only after government certification. Standard drugs must either conform to the official compendia or be clearly labeled with the precise differences from official standards. The definition of adulterated cosmetics in general follows that for food under the old law, with special provision for coal-tar hair dyes. Adulteration with regard to all three classes of goods includes their packing, preparation, or holding under unsanitary conditions.

With regard to misbranding of goods, several loopholes in the old statute were plugged. One food sold under the name of another must be clearly marked "imitation." Foods bearing proprietary names must be labeled with the common or usual name of the food and each ingredient. The quantity label provisions of the old law are supplemented by a provision against containers so formed or filled as to be misleading. Food to be used for special dietary uses must contain such information concerning its vitamin, mineral, and other properties as the Secretary determines to be necessary for full consumer protection. Use of artificial flavoring or coloring and of chemical preservatives must be disclosed on the label. Drugs containing certain specified substances must carry a warning of their habit-forming qualities. Labels must contain adequate directions for use, warnings against unsafe dosage, and disclosure of particular ingredients involving special dangers to the user. The major potential addition to effectiveness of the misbranding provisions is found in a general definition of misbranding applying to the entire Act. It is stated in the following terms:

If an article is alleged to be misbranded because the labeling is mislead ing, then in determining whether the labeling is misleading there shall b taken into account (among other things) not only representations made o suggested by statement, word, design, device, or any combination thereol but also the extent to which the labeling fails to reveal facts material in th light of such representations or material with respect to consequence which may result from the use of the article to which the labeling relate under the conditions of use prescribed in the labeling thereof or unde such conditions of use as are customary or usual.

Protection against repetition of the recent unhappy experience witl sulfanilamide is afforded through special requirements for nev drugs. Before they may be introduced into interstate commerce, ap plication giving full information with regard to the contents mus be filed with the Secretary, together with samples for testing. A wait ing period of sixty days is required for government tests. If new evi dence shows the drug to be unsafe, the application may be furthe suspended, with the result that interstate commerce in the com modity again becomes subject to forfeiture and criminal penalty. Th Secretary is also given power to establish an emergency permit contro system for distribution of foods peculiarly liable to contaminatio during processing.

On the enforcement side, the penalties are sharply increased. The now amount to a year's imprisonment or fine not exceeding $1,00 for a first offense, with subsequent offenses entailing imprisonment u to three years and fine up to $10,000. The forfeiture provisions of th old law remain, although multiple seizures while a forfeiture proceed ing is pending in one jurisdiction are now generally forbidden. Th Act adds a new enforcement technique through injunctions restrain ing continuance of the prohibited actions. This alternative will prov useful in cases where moral turpitude is not involved. It is both mor rapid and less expensive than the criminal procedure.

The most novel procedural innovation formalizes the issuance o regulations under the Act to an extent without precedent in America regulatory legislation. Public hearings must be held upon applicatio of any interested industry or substantial portion thereof before the is suance or amendment of any regulation. Aggrieved parties may obtai judicial review from a circuit court of appeals within three month These provisions lay the rule-making process open to serious delay and may prove an important obstacle to effective administratio How far they will stultify the Act in practice will depend upon th

attitude of the reviewing courts, which have thus far had no opportunity to express themselves.

Except for the provisions dealing with new drugs, the Act by its terms was not to become effective until June, 1939. A subsequent amendment further postponed its operation until 1940. It is consequently impossible at this time to appraise its effectiveness. Many of its provisions will require interpretation in the courts. With the increase in scope of action, the Administration will require enlarged appropriations and more adequate personnel. In recent years, appropriations have shown a gradual upward tendency, ranging from about $1,500,000 in 1933 to almost $3,000,000 in 1940–41. The establishment of roughly 750 employees remains hardly commensurate with the task of enforcement. The material improvement in the law leaves ample scope for further consumer protection.

FALSE ADVERTISING

Elimination of advertising provisions from the Food, Drug, and Cosmetic Bill of 1933 was the leading victory of its opponents. The battle was fought in terms of the proper location of advertising control. Consumer groups and the Food and Drug Administration argued that misleading advertising was so akin to misbranding that it could be defined in almost identical terms and be most effectively prevented by the same agency. The proprietary drug and advertising interests maintained that such control, if imposed at all, should be placed with the agency already active in the advertising field, the Federal Trade Commission. They undoubtedly viewed the Commission's history as assuring less vigorous enforcement. Illogical though the division of control may appear, it was adopted by Congress toward the end of the legislative struggle over the Act.

At this time the Federal Trade Commission's efforts to lessen false advertising in general had been severely curtailed in 1931 by the Supreme Court decision in the *Raladam* case.[7] The Commission's repeated requests for revision of its basic statute, to prohibit "unfair or deceptive acts or practices in commerce" as well as "unfair methods of competition" were in 1938 finally receiving favorable consideration, in the form of the Wheeler-Lea amendment. Advantage was taken of this circumstance to transfer to the same bill special provisions against false advertising of food, drugs, cosmetics, and therapeutic devices.

The Wheeler-Lea Act defines a false advertisement thus:

[7] See below, p. 515.

> The term "false advertisement" means an advertisement, other than labeling, which is misleading in a material respect; and in determining whether any advertisement is misleading, there shall be taken into account (among other things) not only representations made or suggested by statement, word, design, device, sound, or any combination thereof, but also the extent to which the advertisement fails to reveal facts material in the light of such representations or material with respect to consequences which may result from the use of the commodity to which the advertisement relates under the conditions prescribed in said advertisement, or under such conditions as are customary or usual. No advertisement of a drug shall be deemed to be false if it is disseminated only to members of the medical profession, contains no false representation of a material fact, and includes, or is accompanied in each instance by truthful disclosure of, the formula showing quantitatively each ingredient of such drug.[8]

Its prohibitions are enforced through the usual cease and desist orders. The Commission may also bring suit in a federal district court to enjoin dissemination of an allegedly false advertisement pending completion of its ordinary procedure. Where "the use of the commodity advertised may be injurious to health because of the results from such use under the conditions prescribed in the advertisement thereof, or under such conditions as are customary or usual, or if such violation is with intent to defraud or mislead," the advertiser is subject to criminal penalties equal to those under the Food, Drug, and Cosmetic Act.

It will be evident from the terms of the new statute that it almost certainly faces a long court career before its practical meaning is settled. The Commission has begun its administration with enthusiasm, operating through the newly created Radio and Periodical Division. In the law's first twenty-seven months, 991 field investigations were completed, resulting in 221 formal complaints and 204 cease and desist orders. Close liaison is maintained with the Food and Drug Administration.

GOVERNMENT COMMODITY STANDARDS

With the struggle for protection from adulteration, misbranding, and false advertising temporarily transferred from the legislative arena to the care of administrators and judges, consumers have turned to a demand for government commodity standards as the next item on their agenda. "No single change," wrote one observer a decade ago,

[8] Act of March 31, 1938, Public No. 447, 75th Cong., 3rd Sess., Sec. 15.

"would do more to reduce industrial waste, because undoubtedly the greatest waste in industry today is the spending of money for things which fail to give the return expected of them."[9] No government agency could operate on the exact pattern of the private research and testing organizations, but it could go far to assure to consumers a minimum of objectively established basic quality information.

Work in setting official standards for the use of governmental units, scientific organizations, and manufacturers goes back to the establishment of the National Bureau of Standards in 1901. Growing out of the previous Office of Standards, Weights, and Measures, the Bureau has developed an elaborate organization for testing qualities of all sorts. It operates on a budget of about $2,000,000 a year. Although its services play an important part in determining specifications for producers' goods and institutional consumers, ultimate consumers are informed of commodity conformity with its standards only in a handful of exceptional cases. They may, however, receive substantial indirect benefits from its work.

In the agricultural field, the Agricultural Marketing Service has also developed systematic grades which may be used by processors on a voluntary basis. Meat grading has been well established for thirty-five years. The McNary-Mapes amendment of 1930 to the Food and Drug Act, requiring the labeling of substandard canned goods, was sponsored by the National Canners Association in an effort to eliminate entirely the competition of substandard products, although the minimum was intended to be above the line distinguishing wholesome from unwholesome food. Under the leadership of the Consumers' Advisory Board of the National Recovery Administration, vigorous efforts were made to extend the principle of the McNary-Mapes amendment to compulsory grading above the minimum standard. The first version of the new food bill contained such a requirement. While dispensers of private brands were not unfriendly to the proposal, national brand manufacturers and their allied advertising interests feared its reaction on existing good will for their products, which had been created only at great cost. They succeeded in defeating the proposal on both occasions. As finally enacted, the food law simply extended the McNary-Mapes amendment to all foods other than fresh or dried fruits and vegetables.

In a more limited field, attempts have been made for several years to require standard labeling of textiles, particularly woolen or part-

[9] S. H. Slichter, *Modern Economic Society*, 1931, p. 581.

wool goods. Sheep growers are an important factor in this movement. Success was finally achieved through the passage of the federal Wool Products Labeling Act late in 1940. The measure forbids the misbranding of wool products entering into interstate commerce, with regard both to the percentage of wool and to the presence of reprocessed or reused wool in contrast with virgin wool. Enforcement is provided by the Federal Trade Commission through its ordinary cease and desist order procedure, reinforced by court injunction. "Willful" violation is a misdemeanor, subjecting the violator to a fine not exceeding $5,000 or imprisonment up to one year.

The consumer's real hope for general adoption of official quality standards is based upon a sharp division of interest among producers. Many producers already offering high-grade products are inclined to favor proposals enabling them to utilize conformity with government standards as part of their consumer appeal. Co-operatives and large grocery chains in increasing number are adapting their labeling of canned goods to Agriculture Department grades on a voluntary basis. Advertisers, on the other hand, tend on the whole to view the movement with alarm. Thus far, whatever the views of individual members, the bulk of producer organizations have firmly maintained their opposition to it. With a continued increase in consumer consciousness, further defections are to be expected.

3. Consumer Representation in Government

As broad functional interests in the American economy developed powerful organizations, they obtained within the executive establishment agencies designedly devoted to their needs. Departments of Agriculture, Commerce, and Labor were thus created in turn, implementing through functional representation the accepted tradition of special interest promotion. Although Presidents vary in their willingness to recognize vested interests in the three great promotional Departments, all Secretaries of Agriculture have come from farming backgrounds and most Secretaries of Commerce and Labor from business and trade-union backgrounds respectively. In their own self-interest, moreover, these agencies must cultivate the corresponding outside organizations, and through them the appropriate Congressional blocs, as a safeguard for continuance of their funds.

To round out the existing picture, logic would dictate creation of a Department of the Consumer. Its establishment is, in fact, a leading

article of faith among consumer organizations. The form of the executive establishment, however, is not determined by logic alone. A full-blown cabinet department is clearly an overly ambitious objective for the consumer movement in its present inchoate state. But representation on a more modest scale is within the bounds of possibility. Under the New Deal several experiments in this direction have been undertaken.

Consumers were not wholly lacking in government representation before 1933. Besides the Food and Drug Administration, the Bureau of Home Economics in the Department of Agriculture and the Bureau of Labor Statistics in the Department of Labor were both devoted to consumer welfare along with other objectives. The Home Economics Bureau, in particular, while concentrating on the needs of farmers as consumers, has developed a strong consumer bias in general. The weakness of its position was demonstrated by a conflict in November, 1933, with flour interests over a publication recommending a decrease in bread consumption for high-income diets. An effort to cut off appropriations for officials advocating reduced consumption of any wholesome agricultural commodity failed in Congress. But the Bureau took due warning, and the pamphlet, despite a heavy demand, was not reprinted. The Bureau of Labor Statistics, likewise, while giving some attention to promotion of co-operatives and dissemination of information on costs of living, is primarily concerned with the interests of workers as producers.

The assumption that consumers' interests required no special representation in the regulatory process was first successfully challenged in connection with state public utility commissions. The double role of prosecutor in the public interest and judge among contending interests is implicit in the very constitution of the administrative tribunal. No device of organization can wholly eliminate it. Superficial resemblance of commissioners to judicial officers, however, easily leads them to view the public interest in terms simply of any workable compromise among the demands actively presented before them. Growing recognition of a distinction between public interest and consumer interest has on occasion made it seem desirable to obtain active presentation of the consumer's viewpoint as one element in the conflict of forces out of which the public interest is to be derived. To secure this objective, People's Counsels were created in a number of states and in the District of Columbia. Appointed independently of the commissions, they serve as consumers' attorneys in commission proceedings.

A proposal in 1929 to add a similar office to the United States Tariff Commission was defeated. Specific consumer representation in the federal government was finally provided in three emergency New Deal agencies, the National Recovery Administration, the Agricultural Adjustment Administration, and the National Bituminous Coal Commission. Their experience is a significant commentary on the weaknesses inherent in the consumer position under present conditions.

THE NRA CONSUMERS' ADVISORY BOARD

The National Industrial Recovery Act of 1933 contained no hint of the administrative organization through which its terms were to be carried out. On the day of its approval, however, the President announced that the NRA would contain three official advisory boards, to represent industry, labor, and consumers respectively. The industrial and labor boards were to promote the interests of their functional groups as a whole, as contrasted with those of a particular industry or a particular trade-union. Responsibility to outside officials was provided through appointment by the Secretaries of Commerce and Labor. Creation of the third advisory board was only accomplished over considerable protest from General Johnson. He could see no special interest for it to represent, other than the public interest. For this he considered himself responsible. Establishment of a consumers' board, however, was insisted upon by the President. Appointments were made, failing a Consumers' Department, by the Administrator for National Recovery, with the approval of the interdepartmental Special Industrial Recovery Board.

From the outset the Consumers' Advisory Board was a stepchild. It was ably staffed throughout. Although it failed at the start to obtain complete agreement upon the nature of its function, in the course of its two years' existence it made substantial headway toward a workable and concrete definition of consumers' interest in industrial regulation. Its influence on actual code making and code administration, however, was almost negligible. For the first six months of the NRA the exclusive emphasis was upon speed, upon evoking workable compromises from the strongly organized business and labor groups, regardless of considerations of general policy or consumer welfare. The Board's repeated objections to price-fixing and output-limiting provisions were viewed as academic obstructionism. The basic data with which the Board might have backed up prognostications of ill effects

from particular provisions were lacking in almost every instance. The Board also sought to carry its advisory functions into code administration by requesting representation on code authorities. This demand was never met; the closest approach was the ineffective device of consumer advisers to administration members. The first Executive Director, Dr. William F. Ogburn, resigned in August, 1933, in despair over the possibility of effective consumer representation. Subsequent staff members, however, patiently and persistently strove to inject into the Act's administration the gradually crystallizing policies which they considered essential to achievement of its ostensible purposes.

As time wore on, the influence of the Board began to make itself felt in NRA attitudes. When complaints of profiteering, price increases, and discriminatory practices multiplied, coming from both intermediate and ultimate consumers, responsible officials gave more heed to the Board's recommendations. The successive policy committees set up within the organization were strongly influenced in their conclusions by its well-reasoned criticisms, which growing factual experience served to confirm. Congressional antagonists of the NRA also depended heavily upon the Board's work for their oratorical ammunition. In July, 1934, the famous rule against price fixing was issued, although it was then too late to modify the bulk of the code structure. In the various plans for NIRA extension developed before invalidation of the Act by the Supreme Court, consumer representation was given an important role.

To some extent, recommendations of the Consumers' Advisory Board conflicted with the fundamental purposes of the NRA when judged realistically rather than by announced objectives.[10] Its basic defect, however, was clearly its lack of an organized constituency. An interesting effort was made by the Chairman, Mrs. Mary Rumsey, to remedy this deficiency by actively organizing consumers through governmental channels. She sought to establish a consumer council in each of the nation's 3,072 counties. A Bureau of Economic Education was set up within the Board for this purpose, but administration support could not be obtained for the experiment on a nation-wide scale. Instead, a consumers' division was set up in 1934 in the National Emergency Council to organize a trial on a limited basis. About 150 county councils were created and given free office space, secretarial assistance, and the franking privilege. A few have outlived the death of the NRA, but for the most part these artificial institutions did not

[10] See below, pp. 571–595.

generate sufficient pressure to compare with the organized opposition forces. The NRA experience as a whole demonstrated conclusively both the need for special consumer representation and the formidable obstacles which confront it.

THE CONSUMERS' COUNSEL OF THE AGRICULTURAL ADJUSTMENT ADMINISTRATION

The original Agricultural Adjustment Act of 1933, like the NIRA, made no specific provision for consumer representation. Administrator Peek, a close friend of General Johnson, was hostile to the idea and accepted it only under pressure from higher officials. The President and the Secretary of Agriculture felt it desirable to counterbalance the internal representation already afforded to farmers and processors. Frederick C. Howe was therefore appointed to a newly created office of Consumers' Counsel in the early summer of 1933.

His position was anomalous from the outset. The purpose of the AAA, achievement of price parity for farm products, had to be accepted as a framework for his operations. Howe therefore attempted to maintain the consumer position intact by promoting improved distributive efficiency and utmost reduction of price spreads between farmers and the retail market. In practice, however, it proved far easier to align farmers and distributors against consumers than farmers and consumers against the well-entrenched distributors. The Administrator, anxious to obtain quick results, found Consumers' Counsel opposition time consuming and annoyingly obstructive. The difficulties were intensified by the bitter internal policy conflicts marking the early years of the New Deal agricultural program. Peek, who disliked the crop control features from the start, was removed in December, 1933. His successor, Chester C. Davis, came into insoluble conflict with Howe over policy toward distributors under the marketing programs. The latter left office in 1935.

At this stage Administrator Davis undertook a public statement of the functions of the Consumers' Counsel. He saw in the position a twofold responsibility, internal to the administration and external to the consuming public.

Its function, so far as the Agricultural Adjustment Administration is concerned, is to represent the interest of the consumer at every stage in the Administration's activities. When a commodity control program, a marketing agreement, or a licensing agreement is under consideration, it is essential that both producers' and consumers' interests be represented by

> trained economists, highly skilled in research and in the interpretation of economics. In many cases, there is no conflict of interests . . . in some cases, where there is some apparent conflict, on particular points, it is the function of the Consumers' Counsel to represent the consumer and assist in finding the point of maximum justice to both producer and consumer.
>
> Once a program, a marketing agreement, or a license is in effect, it is the function of the Consumers' Counsel to observe its operation and determine whether or not the results anticipated at the time it was framed are actually being obtained. Should it appear that they are not, the counsel has a double duty, a duty to urge reconsideration of the program with the AAA to see if the fault needs to be remedied by a change in the provisions of the program, and a duty to give publicity to the facts as they exist.[11]

While affording some guidance for the office in the future, this statement failed to draw a sufficient distinction between consumer and public. It refused to accept wholeheartedly the position of Consumers' Counsel as involving frank advocacy of a very broad, but nonetheless partial, interest. Implicit in its terms were the difficulties attending such an office when its incumbent is responsible to an agency charged with primary duties of promoting producers' interests.

In practice, the Consumers' Counsel has had only little positive influence on administration of the agricultural program since 1935. Donald E. Montgomery, who succeeded Howe, has consequently expanded his activities in the direction of consumer education. Through regular broadcasts, speeches, press releases, and a fortnightly publication, the *Consumers' Guide,* he has maintained contact with the consumer movement at large. The *Guide,* with a free circulation of 150,000 and a small additional paid circulation, discussed price problems, methods of judging quality, and the general progress of the agricultural program from the consumer viewpoint. At times its contents have occasioned controversy with the AAA over the extent to which they should overstep the boundaries of the Administration's immediate program. The anomalous position of the office in the executive establishment has deprived it of a firm foundation on which to support aggressive promotional activities.

THE CONSUMERS' COUNSEL TO THE NATIONAL BITUMINOUS COAL COMMISSION

The Bituminous Coal Conservation Act of 1935 and its lineal successor, the Bituminous Coal Act of 1937, called for consumer repre-

[11] Quoted in P. Campbell, *Consumer Representation in the New Deal,* 1940, p. 244.

sentation for the first time in specific statutory terms. Almost identical provisions in the two measures were modeled on state laws creating people's counsels for public utility commissions. The Consumers' Counsel was to be appointed by the President and Senate independently of the Coal Commission, and placed in the Interior Department, like the Commission, merely for housekeeping purposes. He was directed "to appear in the interests of the consuming public in any proceeding before the Commission and to conduct such independent investigation of matters relative to the coal industry and the administration of this Act as he may deem necessary to enable him properly to represent the consuming public in any proceeding before the Commission." He might subpoena witnesses through the Commission and was given the right of cross-examination. On his demand the Commission was supposed to furnish "any information at its command, or conduct any investigation as to any matter within its authority." He was also authorized to represent coal consumers' interests in freight rate proceedings before the Interstate Commerce Commission.

The Act of 1935 was invalidated by the Supreme Court before the Consumers' Counsel experiment could be tested. Under the second Act, forceful steps were taken by the Counsel to obtain for himself a part in the elaborate price-fixing process around which the plan revolved. His early conflicts with the Coal Commission were reminiscent of the NRA and AAA experiences. Anxious to bring immediate relief to the industry by establishing minimum prices as quickly as possible, both producer and labor members resented his intervention. Despite the clear command of the statute, he was refused access to data supporting the Commission's decisions. The short-cut price-fixing procedure adopted in 1937, which omitted several steps required by the Act, called forth warm opposition from numerous producing groups as well as large consumers. While the Counsel was taking legal steps to enforce his rights, effectuation of the prices was enjoined in the courts.

The Commission personnel was reorganized in 1938 and became more responsive to Consumers' Counsel demands. The Counsel was now given full access to individual cost data. On his initiative they were also made available to the general public, although only at the expense of a fight in court against recalcitrant producers.[12] Testimony was presented on his behalf at several stages in the evolution of the

[12] *Utah Fuel Company* v. *National Bituminous Coal Commission*, 306 U.S. 56 (1939).

price schedules. It is asserted that this work saved consumers at least $10,000,000 per year.[13] He also appeared before the Interstate Commerce Commission to oppose increases in freight rates for coal. In his own words:

> Success of these efforts has not been apparent as yet. However, [I] have thus developed and impressed on consumers that bituminous coal is bearing a very unfair proportion of the freight rate burden of the country and that the great proportion of this coal revenue is going to railroads which are prosperous.[14]

Besides legal activities within the immediate framework of the Act, the Counsel took steps to interest domestic consumers in the proceedings and to direct their attention to quality standards and other information essential to intelligent buying. Press releases, a small news bulletin, and a motion picture entitled "Know Your Coal" were all employed to this end. On the whole, the Counsel viewed his position as representing all consumers, large and small. Although conflicts between different consuming groups are potentially serious, issues of this type have not yet come to the fore.

In July, 1939, when the Coal Commission was transformed into a division of the Interior Department, the functions of the Consumers' Counsel were assumed by the Solicitor's Office in that Department. The independent statutory status of consumer representation in bituminous coal regulation thereby came to an end. Thus far, however, the program initiated by the Counsel has been maintained with little alteration. With the initial price-fixing process only barely completed, the institution has yet to face its real test. The composition of the Coal Commission, a majority of which was drawn from operators and workers in the industry, doubtless gave to continuous consumers' representation in the regulatory process a more vital role than would be required with purely public agencies.

A CONSUMERS' AGENCY

Experience with limited consumers' representation under the New Deal strengthened the demands of consumers' spokesmen for an independent consumers' agency. In all three instances, it is argued,

[13] *Annual Report of the Consumers' Counsel of the National Bituminous Coal Commission for the Fiscal Year Ending June 30, 1939*, p. 2.

[14] *Ibid.*, p. 3.

ample need was shown for participation of officials devoted solely to presenting the consumer's viewpoint and to promoting his welfare. Further official recognition of this attitude was achieved in the spring of 1940 when a member to represent consumers was included in the Advisory Commission to the Council of National Defense. That these officers were not more effective in attaining their purposes is held to be a consequence partly of their experimental position and partly of defective organization.

Short of a full-fledged department, which is admittedly unattainable for the time being, consumer groups seek a special bureau placed in a more hospitable environment than any of the three existing promotional departments can offer.[15] The Federal Security Agency, established in 1939 to co-ordinate the Social Security Board, the Public Health Service, the United States Employment Service, the Civilian Conservation Corps, and the National Youth Administration, now appears as the most promising context for such a bureau. In 1940, Reorganization Plan Number IV transferred to its supervision the Food and Drug Administration and a number of miscellaneous educational and charitable institutions previously attached to the Interior Department. While by no means entirely functionally integrated, the Agency approaches a general Public Welfare Department more closely than any previous element in the federal establishment.

A new Consumers' Bureau would take over and expand the educational work of the Bureau of Home Economics and the Consumers' Counsel of the AAA. It would co-ordinate efforts of parallel state, local, and private agencies. While not eliminating the need for consumers' representatives attached directly to individual regulatory agencies, it might act as a channel for their appointment. They would thus be relieved of the anomalous position of speaking for one interest while being responsible to officials appointed for the promotion of another. It would seek to aid the further development of the consumer movement at large while building up a body of officials trained to think in consumer terms. One of its major contributions would be the clarification of the meaning of consumers' interest as applied to specific situations.

[15] Two excellent examples of such proposals may be found in S. Nelson, "Representation of the Consumer Interest in the Federal Government," 6 *Law and Contemporary Problems,* 151–164 (Winter, 1939), and P. Campbell, *Consumer Representation in the New Deal,* 1940, pp. 264–272.

4. Consumer Interest and Public Interest

Pluralistic organization has come to rival individualism in the development of modern democratic societies. The trend is not merely unopposed but positively fostered by public policy. Atomization of agricultural, of labor, and of business organizations is rightly viewed as neither possible nor desirable. In seeking to mediate effectively among such groups, government itself is compelled to supplement the traditional technique of judicial determination of individual rights and duties with an elaborate administrative organization and a trained civil service directed positively toward eliciting a public interest out of the welter of interacting partial interests. Early recognition of this need in public utility regulation has been followed more recently by its acceptance in the area of antitrust policy and elsewhere.

Meanwhile, a type of unformalized functional representation has been introduced into the executive branch of government itself. It was carried to an extreme under the National Industrial Recovery Act, where lawmaking and law enforcement were delegated to private industrial and labor associations. The original composition of the National Bituminous Coal Commission was a lesser step in the same direction. The great promotional departments, particularly the Department of Agriculture, which performs among other duties a host of regulatory functions, exemplify the same trend. The ideal of impartial administration, of course, is not wholly abandoned. The unmitigated clash of special interests, without mediation and guidance by active proponents of a public interest, is more likely to produce deadlock than effective governmental action. But direct participation of special interest representatives in administration is no longer viewed as an unhealthy excrescence on a pure body politic. It is welcomed and encouraged.

Under these conditions, the need for consumer representation is intensified. For their own self-defense administrators required a constituency of consumers, as well as of more specialized interests, before whom to justify their actions. In a pluralistic world, unorganized consumers are at the mercy of superior forces. Given their inherent weaknesses, however, organizational initiative must be supplemented by active governmental promotion. Consumer strength within and without the government can only develop in step. If this interest is to make its full contribution to the total equilibrium of forces, government will be the pacemaker.

Part III

GOVERNMENT AS REGULATOR IN THE PUBLIC INTEREST

Chapter Eight. THE GROWTH OF GOVERNMENT REGULATION

1. Conditioning Factors

During the first century of our national history many important changes took place, but none perhaps was so pervasive in its influence on government and economic life as the simple physical fact that a vast continent with rich natural resources was being rapidly occupied and exploited. Public policy became inextricably intertwined with the process of exploitation and development. Groups within the community might disagree about terms and conditions, but most of them shared a sense of continental destiny. The seemingly inexhaustible supply of public land provided material for what the late Professor Parrington once called a National Barbecue; one of the main tasks of government involved the allocation and distribution of the economic surplus.[1]

The rapidity of continental occupation would have been impossible without the technological developments which took place contemporaneously. The building of roads, the cutting of canals, the construction of railroads, and the invention of the telegraph combined to provide transportation and communications networks which did much to facilitate the march across the continent. Here, too, the resources of government were tapped to promote the expansionist trend. At the same time the United States was making the transition from a preindustrial to an industrial economy. The settlement of the West served to obscure the transformation, but at different rates of speed in different parts of the country the impact of the industrial revolution was deeply felt.

[1] See K. B. Smellie, *The American Federal System* (1928), p. 47.

British colonial policy had served to delay the introduction of manufacturing in America, but after the Revolution, and particularly after the War of 1812, numerous manufacturing units were established and the basis was laid for the great era of industrial expansion which followed. Here, too, industrialization was accelerated by generous governmental aid. The extension of such aid met sporadic resistance from agrarian elements, but the resistance was neither sustained nor effective. The process of industrialization went on with increasing speed. Agrarian groups found their hegemony challenged. Other changes followed. In Massachusetts, as Charles Francis Adams once pointed out, the Codfish Aristocracy and the Merchant Princes gave way to the Lords of the Loom. The next generations were to witness the rise of the railroad barons, the captains of industry, and the masters of capital as new industrial and financial empires were carved out.

Economic and legal institutions were shaped to facilitate this expansion. The device of the corporation, although in use in England, had largely lain fallow in this country during the colonial period. The simplicity of economic and social conditions here made widespread resort to it unnecessary. But, as E. M. Dodd has pointed out:

> The political and commercial separation from Great Britain led to an immediate demand for American banking and insurance enterprises, and of these the banks from the outset and the insurance companies at an early date generally assumed the corporate form of organization. The establishment of independence was followed also by an increased interest in such public improvements as canals and toll bridges, and the larger of these enterprises sought and generally obtained incorporation. These early types of corporations were followed during the closing years of the eighteenth century by a substantial number of turnpike and water works corporations and by a few pioneer charters for manufacturing enterprises. . . .[2]

Thus the basis was laid for the expansion which followed. As the new century advanced, one sector of economic life after another came under corporate sway.

Resistances to the corporate system were, of course, encountered. As Justice Brandeis described it, "at first the corporate privilege was granted sparingly; and only when the grant seemed necessary in order to procure for the community some specific benefit otherwise unat-

[2] *Harvard Legal Essays* (1934), pp. 66, 67.

tainable." [3] The relaxation of restriction on corporate size and activity came gradually. In part, it was a reflection of the general desire for business expansion; more immediately, however, it was a manifestation of the growing political power of corporate promoters whose influence in a few strategic states was sufficient to set in motion what Brandeis once called a "race . . . not of diligence but of laxity."

The rapid pace of industrialization and the seemingly boundless opportunities for development gave direction to the growth of business enterprise. With improvements in transportation and with the widening of markets, local businesses became national in scope. With increases in the size of individual businesses also came increasing power on the part of businessmen to shape the national economy. The frontier offered a traditional safety valve for the restless and dissatisfied, but as the years passed and the frontier expanded to its Western limits, the independence of the small farmer and laborer seemed to become more illusory than real. Agriculture felt the impact of mechanization and became closely geared to the compulsions of a business economy. Industrial labor began to be conscious of its decreased bargaining advantages, and sought through organization and pressure on government to repair its position.

It is against this background that the history of the relations of government to economic life unfolds. To depict the first century of this history only in terms of the gradual triumph of laissez-faire doctrine is to miss much. To be sure, mercantilistic regulations dating from the colonial period—such as the power of municipalities to fix the "assize" of bread—were well on the road to disappearance by the first decade of the nineteenth century. But other trends in the direction of expanded government activities were already well in evidence.

As population became more closely knit and urbanization proceeded, functions which had been performed by private individuals were transferred to the domain of public enterprise. Volunteer fire companies became departments of the municipalities. Education was transformed into a public function. Public hospitals were established. Road building passed from private into public hands. The era of the social service state was foreshadowed.

At the same time government played a vigorous role in promoting economic development and in establishing the foundations for the growth of business enterprise. The dearth of private capital for busi-

[3] *Liggett* v. *Lee*, 288 U.S. 517, 541 (1933).

ness enterprise made resort to public credit essential. Where prospective profits were too small to encourage private companies to undertake improvements, the state itself took the lead. Roads were built, bridges constructed, canals cut, and railroads laid by public authorities in order to advance the economic development of particular regions. Public resources were made freely available to private individuals. Loans were made to promote various projects for internal improvements, dams, turnpikes, canals, railroads, and even manufacturing enterprises. Government subscriptions to stock issues in connection with such enterprises were by no means uncommon; the privileges attaching to such stock ownership in some instances enabled political entities to name directors and exercise some supervision over the internal management of the enterprise. Nor was state aid confined to assistance in the form of loans or stock subscriptions. Grants of land, lottery privileges, exemptions from taxation, and other devices were also employed as "encouragement" to private initiative.

Indeed, one of the dominating characteristics of the early history of government intervention in the United States is the extent to which public funds and public resources supported, stimulated, and promoted the spread of business enterprise. The exigencies of a young and undeveloped country carried the day for government aid. The demand for internal improvements was a natural outgrowth of the desire to satisfy the pressing needs of a rapidly expanding country. As the turnpike era gave way to canal "mania" and railroad "mania," the costs of construction were regularly shouldered or shared, first by state and local governments, and later by the federal government.[4]

2. The Beginnings of the Regulatory Movement

The beginnings of what has come to be called the "regulatory movement" are usually traced to the Granger agitation of the seventies. In fact, the roots reach deeper. Even as the corporate system was getting under way, alarms and forebodings began to be heard. An aversion to industrialism and a fear that corporate privileges would produce undesirable concentration of power found early expression in the utterances of leading agrarian spokesmen such as Jefferson and John Taylor. Jefferson's opinion on the constitutionality of a National Bank (1791) breathes this fear. John Taylor, the philosopher of Jeffersonian

[4] See Federal Co-ordinator of Transportation, *Public Aids to Transportation* (1940), 4 Vols. See also Chapter 4.

Democracy, constantly reiterated the dangers of "condensation" of power. Jackson's attack on the Bank and the "money power" was an expression of the same underlying concern. For some of the representatives of Jacksonian Democracy, railroads were undemocratic because they raised the danger of monopoly; they expressed their preferences for common roads—"a real people's road." Jackson himself raised the cry when complaints began to be made that the government was compelled to pay exorbitant rates for railway mail transportation.

Already does the spirit of monopoly begin to exhibit its natural propensities, in attempts to exact from the public . . . the most extravagant compensation. If these claims be persisted in the question may arise whether a combination of citizens, acting under charters of incorporation from the states, can, by a direct refusal, or the demand of an exorbitant price, exclude the United States from the established channels of communication between the different sections of the country; and whether the United States cannot . . . secure to the Post Office Department the use of those roads, by an Act of Congress which shall provide . . . some equitable mode of adjusting the amount of compensation.[5]

In 1838 the first of a series of Congressional acts regulating the rate of payment for mail transportation was passed.

Such regulatory legislation, however, was extremely exceptional during this period. Implicit in the fears of Jeffersonian and Jacksonian Democracy were the seeds of later regulation. But the seeds were a long time coming to full fruition. The fears of the Jeffersonians were strong enough to impose some restraints on an overlavish distribution of public bounty to private interests; they were not strong enough to check the imperious forces which dictated a policy of government aid in a young and undeveloped country. The dread of private monopoly was mingled with a distrust of centralized political power. The Jeffersonian political theory was steeped in agrarianism; its bias was toward local home rule and decentralized political power; it envisaged no large and spacious use of central governmental instrumentalities to direct the economic destinies of the nation.

In this attitude of the agrarian inheritors of the Jeffersonian tradition, there is at least a partial explanation for the fact that the initial thrust of the regulatory movement expressed itself through local and

[5] See L. H. Haney, *Congressional History of Railways in the United States,* Vol. II, p. 201.

state channels and national regulation of economic life in the United States was so long delayed. The struggle against monopoly might lead to efforts to dislodge privileged groups which were entrenched in the national government; it did not take the form of establishing a comprehensive system of central controls to regulate industries which were rapidly becoming nation-wide in scope until the possibilities of local and state control had been thoroughly explored.

The more one ponders the history of the growth of regulation in the United States, the clearer it becomes also that this growth has not been the product of any farsighted plan or design or the result of any thoroughly worked out rationale or theory. Step by step, whether in state or nation, it has represented a series of empirical adjustments to felt abuses. It has been initiated by particular groups to deal with specific evils as they arose, rather than inspired by any general philosophy of governmental control.

3. The Massachusetts Experience and the Spread of Regulation

The essentially pragmatic and experimental character of this growth can be illustrated in a variety of fields. The early development of regulatory commissions in Massachusetts furnishes an interesting example of the process at work.[6] Regulation in Massachusetts began by being primarily legislative. The restrictions on business corporations, contained in some of the early charters, particularly the provisions limiting the size of corporations and providing for limited voting rights for large stockholders, seemed to indicate a certain fear of monopoly; but restrictive provisions did not persist as part of the living law. Among the earliest corporations thus chartered were the banks. Some measure of public control was provided for by a reserved legislative right to examine into the affairs of such banks and inspect their books, and by a requirement for periodic reports. But the legislative investigating committee, as a device of control, revealed serious weaknesses. "Its supervision was necessarily temporary and intermittent; its activities were usually undertaken after the damage had been done; its members, depending on their own genius for discovery, were readily deceived." [7] Influenced by these considerations, a Bank Commission was created in 1838 to provide continuous and intimate super-

[6] See L. D. White, "Origin of Utility Commissions in Massachusetts," 29 *Journal of Political Economy*, 177 (March, 1921).

[7] *Ibid.*, p. 180.

vision of banking affairs within Massachusetts. Although abolished in 1843, it was restored in 1851, with amplified authority, and became a part of the permanent regulatory machinery of the state.

A similar system of control evolved in connection with insurance companies. Legislative visitation and the publicity of reports proved ineffective. Enforcement of rights by private suits in the courts turned out to be inadequate; in the case of foreign companies it often proved difficult to serve writs. A long series of frauds and irregular practices culminated in a series of exposures. Again the expedient of a commission was invoked.

Railroad policy in Massachusetts also began with special acts of incorporation. The result, according to the first Railroad Commissioners' Report in 1869, was that legislation in regard to the five hundred and fifty railroads incorporated was "scattered through 950 special acts: one chapter containing 145 sections of the General Statutes, and 40 general laws passed since those statutes were compiled." This mass of legislation embodied substantially three regulatory principles, besides the reserved right of the state to alter, amend, or repeal charters:

(1) Legislative power to alter and reduce rates when the net income of the railroad company exceeded 10 per cent of its actual cost.
(2) A reservation of legislative right of purchase after a specified period at a price equal to cost plus 10 per cent interest per annum.
(3) From 1836 on, requirements of annual reports.

These principles, in actual practice, were not particularly restrictive. The first was evaded. The second operated to make the cost of state purchase prohibitive. The third was openly flouted. In the early period of railroad construction, railroad promoters were still treated as public favorites; they were allowed, in Judge Cooley's phrase, "to shape the law to suit themselves." The frenzy of railroad building was attended by the growth of powerful railroad lobbies; in L. D. White's words, they "were able to hoodwink the General Court, to defy it, and to manipulate it."

Dissatisfaction with this regime soon became articulate. High rates and complaints of unfair discrimination against certain firms led to a demand for more effective regulation. After five years of struggle against bitter railroad opposition, in 1869 a Railroad Commission was created. Its powers were limited; the "functions assigned to it

were wholly advisory in their nature"; the enforcement of its recommendations was dependent almost entirely on the force of public opinion. As Charles Francis Adams said in 1874, the Commission was "simply a medium, a species of lens by means of which the otherwise scattered and powerless rays of Public Opinion could be concentrated to a focus and brought to bear upon any corporation."

Beginning about 1870, the movement to establish state railroad commissions acquired real momentum. It did not, of course, penetrate all of the states and territories. According to the Cullom Committee: [8]

> Of the 38 states and 8 territories (not including Alaska) . . . in 10 states and 6 territories—16 in all—there is either no regulation in force or practically very little . . . of the 30 states and territories that have taken action, 25 have adopted the commission system, while the remaining 5—Nevada, North Carolina, Oregon, Texas, and Montana—depend upon legislative restrictions without providing any special means for the enforcement of their enactments.

As late as 1886 the Cullom Committee, in commenting on the existing scope of regulation in the states and territories, noted numerous gaps.

> Delaware has not enacted any restrictive legislation for the regulation of railroads. The only action in relation to railroads taken by the legislature of that state in recent years (except the passage of special acts of incorporation) has been the adoption at the sessions of 1875, 1877, 1879, 1883, and 1885 of joint resolutions thanking the railroads of the state for favoring the members with passes.

The territory of Arizona reported that it

> realizes the necessity of railroads to aid in its development, and such legislation as has been enacted has been calculated to encourage the construction of railroads, not to regulate their management.

The Pennsylvania Secretary of Internal Affairs, in analyzing the policy of that state, commented as follows:

[8] Senator Cullom of Illinois was chairman of a Senate Committee appointed in 1886 to investigate complaints against the railroads. The hearings and report of the Cullom Committee were directly instrumental in bringing about federal entrance into the field of railroad regulation. The quotations cited from the Cullom Committee report may be found in Senate Report 46, 49th Cong., 1st Sess.

Railroad lines . . . should not be hampered or embarrassed by any harsh, arbitrary or oppressive regulations whereby their efficiency or remunerative operations would be affected; on the contrary, they are entitled to such fostering care of the Government as is not inconsistent with the general welfare.

After 1870, however, such sentiments were by no means typical. The era of government aid was passing; restrictive legislation was on the increase. In the Eastern states the regulatory commissions which were established tended to follow the Massachusetts pattern of an advisory commission, though even in the East the powers of such commissions were increased as experience revealed the difficulties of regulation without authority. Of an entirely different type were the commissions in some of the Western and Southern states which owed their origin to the Granger movement.[9] There the tendency was to vest the commission with rate-fixing power, and frequently the schedule of maximum rates was embodied in statutory provisions.

4. The Granger Movement

The Granger movement, while properly associated with the growth of effective railroad regulation, also had a wider program. It was anti-money power, antimonopoly, and antimiddleman. Such sentiments were by no means novel in agrarian America. They had already been foreshadowed in a simpler Jacksonian day when the forces of capitalistic development were far less advanced. In the enthusiasm and buoyant hopefulness of the occupation and settlement of the West, the notes of complaint were muffled. But, as hope gave way to disappointment and economic depression bred disillusionment, the old war cries were heard again. This time they called for government regulation.

The Granger movement symbolized a remarkable change in attitude toward the railroads, particularly in the West. The frenzied railroad building of the previous decades had been received by the farmers with delight. Railroads were blessings to be encouraged; the demand was for more and still more railroads; competition could be relied upon to protect the public against unreasonable charges. With the agricultural depression of the late sixties and early seventies this attitude rapidly changed. Railroads which had been hailed as the "harbingers of dawning civilization" were now condemned as "tools

[9] See Chapter 2.

of extortion." Farmers complained that the rate level was extortionate, that gross discrimination was practiced as among localities and individuals, that railroads combined to maintain unfair rates, that they sometimes corrupted state officials, that railroad capital was watered, that stock which farmers purchased to aid in railroad building was rendered worthless by financial manipulation on the part of railroad promoters, and that the West was bound in servitude to "absentee Eastern and European capitalists."

To secure relief, the farmers turned to politics. They gained control of a number of Midwestern state governments and succeeded in enacting a whole series of regulatory laws which have since become famous as Granger legislation.[10]

In Illinois, a Railroad and Warehouse Commission was created in 1871; the Railroad Law of 1873 vested it with power to prepare a schedule of maximum rates for both freight and passenger transportation; unjust discrimination in railroad rates was outlawed. In 1871 the Minnesota legislature prescribed a fixed schedule of maximum rates for passengers and freight and created a railroad commissioner to collect statistics and enforce the railroad laws. In 1874 a board of railway commissioners was created with power to fix the schedule of maximum rates. The Iowa Railroad Act of 1874 followed the earlier Minnesota model of prescribing maximum rates by legislation. The Potter Bill passed by the Wisconsin legislature in 1874 combined legislative prescription of maximum rates with provisions for a railroad commission, which was empowered to reduce rates below the maximum when that could be done without injury to the railroad. Similar legislation was enacted in a number of other Western states.

The Granger legislation met intense railroad opposition. Warnings were issued that the railroads would be compelled to abstain from future railroad construction because sufficient capital would not be available for investment in states with restrictive railroad legislation. In some instances railroad management openly defied the law and refused to obey any of its provisions. In others, appeals were taken to the courts on the ground that the legislation was unconstitutional. In still other instances, railroads appeared to obey the law but exploited its loopholes in such a fashion as to make its incidence as obnoxious as possible. All inconveniences suffered by shippers and passengers were attributed to the requirements of the law. Legislative

[10] See S. J. Buck, *The Granger Movement* (1913).

pressure was exerted to cripple the administrative efficiency of commissions by raising cries of economy in order to cut down their appropriations. In almost every instance sustained efforts were made to repeal or modify the law.

The railroad strategy was crowned with considerable success. In 1874 the Minnesota legislation was modified and made acceptable to the railroads. In 1876 the Wisconsin law was similarly amended. In 1878 the Iowa legislation was practically repealed. The Granger leaders were unable to hold their supporters. By the end of the eighteen-seventies better market prices for farm products and lower freight rates, doubtless adopted in part in response to the regulatory measures, robbed the movement of much of its momentum.

The Granger crusade, nevertheless, left its impress on the regulatory movement in the United States. "On the whole," comments the historian of the Granger movement, "it is not too much to say that the fundamental principles upon which American regulation of railroads by legislation has developed were first worked out in the Granger states of the Northwest during the decade of the seventies." [11] The establishment of a commission with power to fix maximum rates, the attempt to prevent discrimination by "short-haul" clauses, the effort to preserve competition by outlawing the consolidation of parallel lines, the legislation against free passes to public officials—all these were Granger contributions.

Another important result of the Granger movement was the opportunity which it gave to the Supreme Court, in the Granger cases, to uphold the constitutional validity of state regulation of railroads and grain elevator rates. To be sure, Chief Justice Waite's distinction in *Munn* v. *Illinois*,[12] between a business clothed with a public interest and one *juris privati,* became in the hands of more conservative justices what Justice Frankfurter once called "an imprisoning definition of the allowable scope of legislation." But at the time and in the given instance, Waite lent the sanction of the Court to an extension of the frontiers of control. The emphasis of the decision was on the power of the legislature to fix rates. In rebuffing the claim that the determination of the reasonableness of rates was a matter for the courts to decide, Waite took an advanced position, from which it was later found expedient to retreat. But before fears of unrestricted legislative control had erected judicial bulwarks against possible "confisca-

[11] See Buck, *op. cit.*, p. 205.

[12] 94 U.S. 113 (1877).

cation" of railroad profits, a highway had at least been opened for the kind of regulatory legislation of which the Granger Acts were a significant example.

5. National Regulation

The Granger movement had one other important consequence. It gave added support to the growing movement for national regulation of railroad rates.[13] The agitation for national control of railroads, to be sure, antedated the Granger movement. As early as 1846 a memorial was presented to Congress for the construction of a government railroad to the Pacific. Two years later Senator Benton of Missouri presented a plan for a similar road to be constructed by the government and to be let in sections to individuals and companies under a stipulation of reasonable rates. Nothing came of these schemes. The Pacific railways which were constructed in the next two decades received extensive governmental aid, but ownership and control remained private. The Union Pacific charter of 1862 did contain a provision for the appointment of two government directors out of a total of fifteen, and the amended charter of 1864 provided for five such directors out of a total of twenty, but there is little evidence to indicate that the minority representation which the government enjoyed in the directorate had any appreciable effect on Union Pacific policy.[14]

Until 1868 relatively little was said in Congress concerning the regulation of railroad rates. In that year signs of a shift of policy began to be evident. Three resolutions were introduced which looked toward rate regulation; the House Committee on Roads and Canals submitted the first Congressional report, holding that railroad rate regulation was both constitutional and expedient. Although nothing came of this report immediately, each new session of Congress witnessed continuous and rising interest in measures for railroad regulation.

The agrarian discontent of the seventies intensified this interest. The federal government was urged to construct and operate a railroad from the Mississippi River to the seaboard in order to secure cheap transportation to the Eastern markets for the produce of West-

[13] See Haney, *op. cit.*

[14] The provision for government directorships was terminated in the course of the Union Pacific Reorganization of 1897.

ern farmers. In December, 1872, President Grant suggested the appointment of a Congressional committee to consider "various enterprises for the more certain and cheaper transportation of the constantly increasing Western and Southwestern products to the Atlantic seaboard." The "Windom Committee" which resulted filed its report in 1874. Its key solution was more competition as a method of lowering railroad rates. To encourage competition, it recommended the improvement of the natural waterways of the country. While it did not, in so many words, endorse construction of a government railroad running from the Mississippi to the Atlantic seaboard, it did state that "the only means of securing and maintaining reliable and effective competition between railways is the national or state ownership, or control, of one or more lines, which, being unable to enter into combinations, will serve as regulators of other lines."

By this time Granger agitation was at its height. In 1873 the Iowa State Grange resolved to petition Congress to "regulate without delay, by a just and equitable law, the freights and fares of all railroads within the United States." Similar petitions poured in from other Granger states. The House at last responded to this clamor. After a stormy debate and a vote in which the sectional alignment of the West against the East was unmistakable, the House in 1874 by a vote of 121 to 116 passed the McCrary Bill. This bill, which had been introduced by an Iowa representative, called for the creation of a federal commission with the power to fix maximum rates, summon witnesses, investigate complaints, and prepare charges against the carriers. The Senate took no action, and the bill failed to become law.

Up to this time the burden of complaints against the railroads had been the high rate level; with the decline in rates, during the late seventies, the regulatory movement focused on the effort to abolish unjust discriminations as between persons and places. In 1878, Congressman Reagan of Texas introduced a bill which was primarily directed against this evil. Discriminatory rates, the granting of rebates and drawbacks, and pools for the distribution of freight earnings were to be forbidden. A drastic long and short haul clause was included in the bill.[15] Schedules of rates were to be posted conspicuously by the railroads, and a five-day notice of rate changes was to be re-

[15] Long and short haul clauses are generally intended to prevent railroads from charging more for a short than for a long haul, when the haul is on the same line and in the same direction and the shorter distance is included within the longer distance.

quired. The bill did not contemplate the creation of a commission; enforcement was provided through the courts. The bill passed the House by a vote of 139 to 104. A comparison of the sectional distribution of the vote with that on the McCrary Bill is interesting. It reveals that, while New England continued adamant against federal railroad regulation, the proponents of railroad regulation were now able to muster a majority in the Middle Atlantic and Southern states as well as in the West. The Senate, however, again refused to take any action.

But by this time it was becoming increasingly apparent that federal railroad regulation was only a question of time. The agitation for regulation was no longer merely an agrarian war cry. Merchants, manufacturers, millers, packers, and boards of trade were adding their voices and strength to the movement. The railroad question became one of the chief Congressional concerns, and bills continued to be introduced and discussed at every session. In 1885 the House passed the Reagan Bill for the second time. The Senate was finally stirred to action, and in the same year the Cullom Bill, which provided for the creation of a federal commission to regulate railroads, won a favorable vote of 43 to 12. At this juncture, on motion of Senator Cullom of Illinois, a select committee of five Senators was appointed to investigate and report on the necessity for regulation of railroad and water rates. The investigation was elaborate. Hearings were held by the Committee in all parts of the country, and the demand for federal regulation was found to be unmistakable. The Cullom Committee report concluded: "It is the deliberate judgment of the committee that upon no public question are the people so nearly unanimous as upon the proposition that Congress should undertake in some way the regulation of interstate commerce."

By 1886 the conditions were ripe for federal regulation. The decision of the Supreme Court in the *Wabash* case [16] made it imperative. Earlier, in one of the Granger cases, *Peik* v. *Chicago and Northwestern Ry. Co.*,[17] the Supreme Court had said: "Until Congress undertakes to legislate for those who are without the state, Wisconsin may provide for those within, even though it may indirectly affect those without." In the *Wabash* case the railroads argued that the state had no power to regulate freight charges for that part

[16] 118 U.S. 557 (1886).
[17] 94 U.S. 164 (1877).

of an interstate journey which was within the boundaries of a state, on the ground that control of interstate shipments was exclusively vested in the federal government, whether or not it chose to exercise its authority. This contention was upheld by Justice Miller in the *Wabash* case:

When it is attempted to apply to transportation through an entire series of states a principle of this kind, and each one of the states shall attempt to establish its own rates of transportation, its own methods to prevent discrimination in rates, or to permit it, the deleterious influence upon the freedom of commerce among the states . . . cannot be overestimated. That this species of regulation is one which must be . . . of a general and national character, and cannot be safely and wisely remitted to local rules and local regulations, we think is clear.

This decision intensified the pressure for federal regulation, since without federal action a large portion of all railroad traffic would have been outside the reach of any regulatory authority.

The movement for federal regulation now came to a rapid climax. In February, 1886, Senator Cullom had introduced a new bill aimed primarily at outlawing discrimination in its various forms. This bill provided for the establishment of a Commission. It passed the Senate 47 to 11. The House replied by re-enacting the Reagan Bill by a vote of 192 to 41. The two bills then went to conference, and a compromise bill was reported which accepted the House demand that pooling be declared illegal and adopted the Senate provision for an administrative commission to regulate rates and limit discrimination. The bill in its final form passed the Senate by a vote of 37 to 12 and the House by a vote of 219 to 41.

With the creation of the Interstate Commerce Commission, a foundation was laid for national assumption of regulatory responsibilities in the field of economic enterprise. If the first steps were feeble and hesitant, the transforming character of the impulse which the organization of the Interstate Commerce Commission gave to subsequent expansion of national regulatory authority was significant and far reaching.

The establishment of the Interstate Commerce Commission was the culmination of a long agitation. That period of preparation, with its shifts in attitude and changes in point of view, is itself a fascinating record of the pragmatic erosion of laissez-faire doctrine in the United States. Agrarian forces distrustful of central controls

found themselves compelled to invoke national power in order to come to grips with economic organizations that eluded local jurisdictions. Merchants and industrialists, imbued with a profound belief in the virtues of limited government, discovered that it was necessary to strengthen government in order to remedy abuses which bore heavily upon them.

The Interstate Commerce Act thus became a dramatic symbol of the end of one era and the ushering in of a new. It marked the end of a century of expansion in the course of which a continent was occupied, industry became national in scope, and government helped to create new engines of wealth and power that threatened to evade all effective control. It stood at the threshold of a new era when to an increasing degree the consequences of the first period of industrial development and exploitation began to be critically appraised, and when the resulting uneasiness crystallized in the creation of new instruments of national power to control and direct policy in important sectors of the economy.

Chapter Nine. RAILROAD REGULATION AND THE CO-ORDINATION OF TRANSPORTATION

1. Public Policy and Parties-in-Interest in Railroad Regulation

"Public policy," observed an English judge more than a century ago, "—it is a very unruly horse, and when you once get astride it, you never know where it will carry you." More than a half century of federal regulation of railroads has carried us far, even if it has yet to vouchsafe an ultimate destination. It has witnessed a transformation in the philosophy of regulation from the negative, restrictive conception which seeks merely to stamp out past abuses to the positive, guiding principle which assumes at least some affirmative governmental responsibility for planning and directing development. It has been marked by a widening jurisdiction over railroad activities and the penetration of regulatory authority into other fields of transportation, such as air, motor, and water carriers. It has seen a strengthening of the movement to entrust industrial controls to independent commissions endowed with special competence and experience and exercising large discretionary powers relatively free from interference by courts, Congress, and the Chief Executive.

The regulatory process as it operates in the railroad field finds a focal point in the activities of the Interstate Commerce Commission. But other regulatory instruments cannot be disregarded. Congress formulates the policies and controls the budget of the Interstate Commerce Commission; the President makes appointments subject to Senatorial approval and may initiate himself important transportation policies; the courts reserve some power to overrule the decisions of the Commission. Public policy with reference to

railroads is thus a joint product of the interplay of all these governmental agencies.

The regulatory machinery, moreover, does not operate in a vacuum. Important parties-in-interest have a vital stake in the formulation, execution, and—on occasion—frustration of public policy. They seek to make their influence felt. A realistic examination of the regulatory process must take them into account, consider their claims, their demands, and the intensity of the pressure which they are able to bring to bear on the contest to determine policy.

Among the major parties-in-interest concerned in railroad regulation the following are worthy of special notice: (1) consumers of railroad service—shippers and passengers; (2) railroad labor; (3) railroad management; (4) financial control groups; (5) railroad investors; (6) the railroad equipment and supply industries; and (7) competing forms of transportation.

If consumers of railroad service are placed first on this list, it is because, historically at least, consumer complaints provided the initial impetus to the regulatory movement. Consumers as a group are primarily interested in low rates and adequate service. They will operate as a reasonably homogenous unit to oppose general rate increases, but from that point on the common front breaks down. In the struggle for advantageous rate treatment, cleavages develop between freight and passenger groups, between large and small shippers, between commodity groups, and between locality and sectional interests. The consumers of railroad service vary, moreover, in the degree to which they make use of that service and in the extent of their organized activity. The freight traffic studies sponsored by the Federal Co-ordinator of Transportation estimated that there were some 215,000 shippers who annually shipped six or more carloads of freight, and that of these 100,000 shipped more than one hundred cars annually. This group, which purchases large quantities of transportation service, has a direct and vital interest in railroad regulation; it is well informed, organized, and articulate. It has its counterpart in the passenger field in the groups of travelers who make extensive use of the railroads—such as traveling salesmen and commuters, though these groups are less well organized even if transportation conscious. The consumers' interest also includes a large number of casual shippers and occasional travelers by rail; but since the interest of individual members of this group is small and indirect, they cannot be easily welded into an effective organiza-

tion. As a result they are largely inarticulate on railroad issues; the organized large-scale shippers and functional organizations of shippers on a commodity basis such as trade associations claim the center of the stage.

It is also worth noting that the national government is itself a shipper and that under certain circumstances various governmental agencies may undertake to represent specific consumers' interests in proceedings before the Interstate Commerce Commission. Section 16 of the Bituminous Coal Act of 1937 vests the National Bituminous Coal Commission (now the Bituminous Coal Division of the Department of the Interior) and its Consumers' Counsel with authority "to make complaints to the Interstate Commerce Commission with respect to rates, charges, tariffs and practices relating to the transportation of coal, and to prosecute the same." In cases involving the transportation of coal, the Interstate Commerce Commission is required to notify the Bituminous Coal Division and the Consumers' Counsel and to permit them to be heard. The Agricultural Adjustment Act of 1938 provides that the Secretary of Agriculture shall appear before the Interstate Commerce Commission in a similar capacity when transportation rates on farm products are at issue. This effort to lend governmental support to specific consumers' interests which appear to need more effective representation introduces an interesting new bargaining factor into the determination of the rate structure.

Railroad labor constitutes a second important party-in-interest in railroad regulation. In 1939 the number of railway employees averaged about a million; this figure represented a striking decrease from the 1920 total of over two million and the 1929 average of over a million and a half. This decrease was accounted for by a combination of circumstances—the inroads of competing modes of transportation, the introduction of labor-saving devices and methods, and the loss in traffic resulting from business depression. Railway wages constitute the largest item in railway operating expenses (more than 63 per cent of the total operating expenses in 1936); when traffic declines the natural tendency of management is to prune expenses by laying off labor. The interests of railroad labor focus on gainful employment. They involve the desire for high wages, steady employment, good working conditions, protection against the insecurities of old age and unemployment, and satisfactory machinery for the settlement of grievances. The aims of railway labor and

management converge when the question is one of protecting railroads from the competition of other carriers. They diverge when labor seeks privileges viewed by management as unwarranted or when management seeks to shift the burden of secular and cyclical readjustments to labor. In periods of contraction the conflicting interests of labor, management, investors, and users of railroad service are given sharp emphasis.

Railroad labor is strongly organized and capable of exerting considerable political power to enforce its demands. More than 75 per cent of railroad employees adhere to recognized unions; collective bargaining is resorted to in the first instance to secure recognition for labor's needs, but when private negotiation proves unsatisfactory, the force of railroad labor is canalized into political channels. A long series of railway labor acts bears witness to the power which railway labor has succeeded in mobilizing in this sphere.[1]

Railway management constitutes still another important party-in-interest in railroad regulation. If size alone be considered, the group is small; the Interstate Commerce Commission classification of "executives, officials and staff assistants" embraced less than twelve thousand persons in 1939. But numbers are not the only criterion of political power. Since the actual responsibility for directing the day-to-day operations of the railways rests on this group, its attitude toward government regulation is important. The group as a whole has long since ceased to oppose the right of government to regulate the railroads as such. It maintains, however, that if railroads are to be regulated, competing modes of transportation ought also to be subjected to a regulatory regime. Otherwise, railroad management ought to be left free to meet competition. The resentment of management is directed against the intrusion of the Interstate Commerce Commission into what it regards as its own field of "managerial discretion." Co-ordination and consolidation projects which threaten established positions are regarded with suspicion, particularly by those who fear that they will be the sufferers by the change. The principle of private ownership of railroads receives warm support. Some of the leading managing personnel are part owners and directors of their roads; most of them are dependent on the favor of financial groups which dominate the controls in the railroad field. Their loyalties naturally extend to the control groups; their attitude toward railroad regulation is, therefore, in

[1] See Chapter 6.

large part determined by the policies which the control groups enunciate.

The strategic significance of the control groups in railroad regulation needs no underlining. By control groups are meant those who actually exercise the power of making ultimate decisions, subject to such regulatory authority as exists and such influence as management can exert. In some cases the power of control groups may derive from a considerable investment in railroad securities, and in such instances it may be difficult to draw a sharp line of demarcation between control groups and other railroad investing interests. In many cases, however, the convenient devices of corporation law and the dependence of the railroads on the capital market have resulted in concentrating the power over policy in the hands of certain financial interests whose direct ownership stake in the railroads is relatively small but whose pervasive influence is extensive. Where such financial interests dominate the controls, their natural tendency is to resent regulatory measures which challenge their ascendancy and limit the opportunities for personal enrichment inherent in control. The financial history of many railroads in the United States demonstrates that the interests of the control groups and the interests of the bulk of small investors in fixed-income securities are not necessarily the same. While both may unite in pressing for higher rates and lower wages, their interests diverge when the control groups divert corporation income and assets to uses which endanger the financial stability of the enterprise. Railroad reorganizations reveal such conflicts of interests in their most acute form; in the past, at least, they frequently provided opportunities for mulcting the unorganized investors.[2]

The railroad investing interest has become, to an increasing degree, an organized and coherent interest. In the early days of railroading in the United States, a goodly proportion of the capital was supplied by foreign investors. Such influence on public policy in the United States as they enjoyed was largely exerted through the financial houses in the United States which aided in the distribution of the securities. With the growth of the capital market in the United States, most of the railroad debt has now been transferred to domestic ownership, and much of it to so-called institutional investors. Of the total net railroad funded debt of $11,834,000,000 at the end of the year of 1936, nearly 56 per cent, or $6,617,000,000, was held by insurance companies, banks,

[2] See Max Lowenthal, *The Investor Pays* (1933).

endowed educational institutions, and foundations.[8] Life insurance companies alone accounted for a total of $3,267,000,000. Indirectly, therefore, the railroad investing interest embraces a large number of citizens whose hope of future security is dependent on the stability and earning power of American railroads.

The interest of the small investor in railroad regulation is reasonably clear. He is concerned about the safety of his investment and, therefore, is likely to be friendly to such regulation of security issues, consolidations, and reorganizations as is designed to protect him from exploitation by "insiders." At the same time, railroad regulation is not calculated to give him much satisfaction unless it also affords a reasonable prospect of adequate and stable earnings on his investment. Spokesmen for investors, therefore, are likely to exert their influence in support of such public policies as will ensure continuity in earnings; they are apt to favor such increases in the rate level and such reductions in operating expenses—including the wage bill—as will provide a margin of safety for meeting fixed charges. The inability of a large group of railroads to meet fixed charges in recent years has forced many investors to face the unpalatable prospect of heavy losses; their understandable reluctance to accept a scaling down of fixed charges has led many of them to view with favor proposals for government subsidies, government guarantee of earnings, and some of them have even turned to government ownership in the hope of salvaging their investment. Meanwhile, the depressed condition of many railroads has made access to the capital market difficult. The unwillingness of private investors to purchase railroad securities has forced government to come to the rescue. Through the Reconstruction Finance Corporation and the Public Works Administration, the national government itself has become an investor in railroad securities to the extent of approximately $500,000,000. The salvaging of these loans may involve the government in conflicts of interest with other groups of investors; a continuation of the role of the government as a supplier of railroad capital beyond the present emergency would involve a considerable modification of the traditional relationship of parties-in-interest in railroad regulation.

Another important but sometimes overlooked party-in-interest in railroad regulation are the railway equipment and supply industries. In prosperous times railroads are heavy consumers of steel, coal, lum-

[8] *Ex parte 123*, 226 I.C.C. 41 (1938).

ber, oil, and other basic commodities and supplies; many industrial plants and communities are dependent upon railroad purchases for their continued existence. Such affiliated interests have an immediate and direct stake in the railroad problem; they stand to benefit when the railroad plant is maintained and improved. Hence their interest in the profitable operation of railroads and in the flow of capital into the industry. Since their business relationships bring them into close contact with railroad management, a community of interest is established in support of the political program of management. The supply groups, however, are also users of transportation service; in their capacity as consumers they are as eager as any other shipper group to secure low rates.[4]

The interest of other forms of transportation in railroad regulation is perhaps so obvious as hardly to merit comment. In the early days of railroading the railroads were regarded as invaders—canal companies sought legal and political protection to prevent the railroads from challenging their hegemony. In more recent times, railroads have been compelled to duplicate the strategy of the canal companies. The extraordinary growth of competing modes of transportation—by highway, water, air, and pipe lines—has forced the railroads to seek political support in meeting the challenge of their competitors. The railroad campaign has taken two somewhat different directions: first, a demand for the repeal of such regulatory measures as appear to hamper the ability of the railroads to compete with other transportation agencies; and, second, the demand that competitors be subject to precisely the same kind of regulatory regime to which the railroads must conform. Public policy appears to be crystallizing around the second alternative, with the hope of developing an integrated transportation system in which each form of transportation will find its proper place. Meanwhile, the competition between rival carriers is bitter and intense. This struggle and the agitation which it produces in the political arena form an important part of the regulatory process.

This catalogue of the more important parties-in-interest in railroad regulation is not intended to provide an exhaustive analysis of their

[4] The singular case of coal merits special note. Railroads are the largest consumers of coal; at the same time freight charges are on the average over 50 per cent of the delivered cost of coal, and some railroads depend heavily on revenue from coal traffic for profitable operation. Consequently there is a sharp conflict between the interest of the railroads in high freight rates and low coal prices at the mine and the interest of the coal operator in high coal prices at the mine and low freight rates.

interrelationships, combinations, and conflicts. At best it is simply an indication of the intricate web of adjustments which the search for the substance of public interest involves. Out of the complex of these interacting pressures, desires are generated and purposes emerge to which agencies engaged in the regulation of transportation are in different degrees sensitive. The alignment varies with the particular problem. Yet there are continuities in the dominant purposes of the important parties-in-interest which provide a clue to their conduct and indicate the feasibilities, if not always the desirabilities, of public policy.

2. The Pressure for Regulation

An analysis of the development of public policy in the railroad field in terms of parties-in-interest throws considerable light on the dynamics of the regulatory process. In the early days of railroading, the dominant policy of government was one of aid rather than regulation. Railroad promoters were viewed as public benefactors; there was consequently little disposition or apparent need to erect safeguards to protect other parties-in-interest in railroading. New opportunities for employment seemed to open up for labor. The investor found the prospect of profits enticing. To consumers, railroads appeared incomparably superior to roads and waterways. The promise of swift transportation, industrial development, and access to markets dwarfed the problem of costs. Sanguine expectations combined with real benefits to produce a pattern of public policy in which the communal interest was identified with the interests of railroad management and control. The result, as Judge Cooley pointed out in the first annual report of the Interstate Commerce Commission, was that "the carriers of the country were . . . enabled to determine in great measure what rules should govern the transportation of persons and property; rules which intimately concerned the commercial, industrial, and social life of the people. . . ." [5]

Abuses of the power vested in corporate management produced the demand for regulation. Other parties-in-interest began to assert themselves as independent entities with programs of control which were in conflict with the objectives of railroad management. The community of interest was shattered. The Granger movement of the seventies, with its agrarian uprising against the prevailing level of

[5] *First Annual Report of the I.C.C.* (1887), p. 4.

high rates, symbolized the rupture. Though the Grangers soon lost power and many of their more stringent controls over state railroads were abandoned, a smoldering resentment persisted and provided support for the emergence of national regulation in the next decade.

The movement for national regulation began essentially as a shippers' movement. The trend of the votes on Congressional bills to regulate the railroads during the seventies and eighties indicates that the bulk of support was at first concentrated in agrarian regions in the West; however, as small businessmen in the East also began to feel the pinch of discrimination they, too, joined in the demand for regulation. The hearings of the Cullom Committee, with its impressive procession of merchants protesting against special arrangements made by the railroads with large manufacturers and dealers, would appear to verify this analysis. An aroused shippers' interest—consisting in the main of smaller businessmen and farmers—and protesting primarily against discrimination rather than the general rate level, provided the driving impetus behind the movement to establish the Interstate Commerce Commission. "The paramount evil chargeable against the operation of the transportation system of the United States as now conducted," reported the Cullom Committee, "is unjust discrimination between persons, places, commodities, or particular descriptions of traffic." [6] Other parties-in-interest, although conscious of grievances, were neither sufficiently organized nor effective enough to find political expression. Railroad labor was still weak. Investors who had suffered from the recklessness of corporate management were as yet unprepared to press for political remedies. The burden of sponsoring regulation was, therefore, shouldered by the shippers; the objectives embodied in the original Act to regulate commerce were shippers' objectives.

3. The Interstate Commerce Commission—Creation and Frustration

The Act of 1887 was a very modest beginning in national regulation of the railroads. It reaffirmed the common-law principle that rates shall be "reasonable and just." Carriers were required to publish rate schedules and give ten days' notice of advance in rates. The Act declared illegal special rates, rebates, and drawbacks, as well as other forms of unjust discrimination between persons, places, and com-

[6] See S. Rept. 46, 49th Cong., 1st Sess. (1886), p. 215.

modities. It sought to enforce competition by forbidding pooling; it also contained a "long and short haul" clause, which made it unlawful for a carrier to charge more "for a shorter than for a longer distance over the same line, in the same direction, the shorter being included within the longer distance." The Interstate Commerce Commission, however, was authorized to make justifiable exceptions, and the clause was not enforceable except where the transportation was "under substantially similar circumstances and conditions."

The authority conferred upon the Interstate Commerce Commission was limited. It could gather statistical and other information from the railroads and require annual reports. It was empowered to receive and investigate complaints; in the event of a violation of the law it might notify the common carrier "to cease and desist or make reparation," but it could not compel obedience except by obtaining an enforcing order in the United States circuit courts.

The problem of sanctions did not, at first, present itself as crucial. Although the Commission noted in its first report that "some carriers . . . are not as yet in their operations conforming in all respects to [the Act's] spirit and purpose," [7] it also noted a tendency to put an end to free passes, rebates, drawbacks, and special rates; and, with announcements of rate reductions and the disbanding of pools, it felt justified in concluding that "the operation of the act has in general been beneficial." [8] These expressions of satisfaction were short lived. The honeymoon era of regulation was soon over. The period following the creation of the Interstate Commerce Commission turned out to be less prosperous than the preceding period; the railroads placed the blame on the Act. The prohibitions of pooling and the long and short haul clause were the subject of particular attack. Within a year after the passage of the Act, evasion became commonplace. The Interstate Commerce Commission report of 1890 quoted one of the railroad managers as saying, ". . . the situation in the West is so bad that it could hardly be worse. Rates are absolutely demoralized . . . certain shippers are allowed heavy rebates, while others are made to pay full rates. Some of these shippers are constantly afraid of being hauled up before the Interstate Commerce Commission, but they need have no fear from that direction. The management of rates is dishonest on all sides, and there is not a road in the country that can be accused of living up to the rules of the interstate commerce law.

[7] *First Annual Report of the I.C.C.* (1887), p. 41.

[8] *Ibid.*, p. 42.

Of course when some poor devil comes along and wants a pass to save him from starvation, he has several clauses from the interstate act read to him. But when a rich shipper wants a pass, why, he gets it at once." [9]

The Commission sought to eliminate these discriminations, but its effort to enforce the Act was frustrated from a number of directions. The Commission's staff was much too small to police all the railroads in the country. Even when violations were suspected, it was extremely difficult to obtain evidence. Witnesses refused to testify, pleading immunity under the Fifth Amendment. A Supreme Court decision [10] in 1892, upholding the refusal of a shipper to testify concerning the alleged acceptance of a rebate, made necessary the passage of the Compulsory Testimony Act of 1893, which guaranteed the immunity of witnesses before the I.C.C. from future punishment. The constitutionality of this Act was finally upheld in *Brown* v. *Walker* in 1896.[11]

The Commission encountered serious obstacles in enforcing its orders in the courts. The procedure was unsatisfactory; it meant long delays. When enforcement was sought in the courts, cases were tried *de novo;* the railroads were permitted to present new evidence, including evidence which had been held back in the original hearing before the Interstate Commerce Commission.[12] The limits imposed on the discretion of the Commission and the difficulties growing out of its inability to provide prompt relief to complainants served to discredit the Commission as an effective enforcement agency.

[9] *Fourth Annual Report of the I.C.C.* (1890), p. 25.

[10] *Counselman* v. *Hitchcock,* 142 U.S. 547.

[11] 161 U.S. 591.

[12] The early attitude of the courts toward the Commission is typified by Judge Jackson's remarks in *Kentucky and Indiana Bridge Company* v. *Louisville and Nashville Railroad,* 37 Fed. 567 (1889):

"It is clear that this court is not confined to a mere re-examination of the case as heard and reported by the commission, but hears and determines the cause de novo, upon proper pleadings and proofs, the latter including not only the prima facie facts reported by the Commission, but all such other and further testimony as either party may introduce bearing upon the matters in controversy."

Although the Supreme Court (*Social Circle* case, 1896) later expressed its disapproval "of such a method of procedure on the part of the railroad companies as should lead them to withhold the larger part of their evidence from the Commission and first adduce it in the circuit court," it also added that "we do not mean, of course, that either party, in a trial in the court is to be restricted to the evidence that was before the Commission, but that the purposes of the act call for a full inquiry by the Commission into all the circumstances and conditions pertinent to the questions involved." 162 U.S. 184.

The rout of the Commission was completed by a series of Supreme Court decisions in 1896–97. It was generally recognized that the Act of 1887 gave the Commission no blanket power to determine rates in the first instance, but the Commission did believe that the Act enabled it to declare whether particular rates were unreasonable and to prescribe maximum rates in correcting such unreasonableness. In the *Social Circle* case[13] (1896), however, the Supreme Court remarked that it was unable to find any such authorization in the Act either "expressly or by necessary implication," and in the *Maximum Rate* case[14] (1897) it reiterated its assertion that the Commission "had no power to prescribe a rate for the future, although its right to pass upon the reasonableness or unreasonableness of rates could not be questioned." In other words, the Commission could declare the existence of evils; it could not prescribe remedies.

At the same time the Supreme Court also handed down a series of decisions which meant the virtual collapse of the long and short haul clause, as it had previously been interpreted by the Commission. The most important of these emasculating decisions were the *Import Rate* and *Alabama Midland* cases. In the first, *Texas & Pacific Railway Company* v. *Interstate Commerce Commission*[15] (1896), the issue was whether the long and short haul prohibition forbade a lower rate for the long haul when the traffic originated from a foreign point and passed through American seaports to another American point. The Commission ordered the railroads in this case not to accept less as their share of the rate on imported goods than they charged on domestic traffic of the same kind between the same points. The Supreme Court overruled the Commission. Since competition for import traffic was active and vigorous, the circumstances of the traffic were dissimilar and lower rates on the import traffic were justified.

The final blow came in *Interstate Commerce Commission* v. *Alabama Midland Railway Company*[16] (1897). This case dealt entirely with domestic rates. The Commission had held that competition between interstate railways did not create dissimilarity, except in rare and unusual cases. The Supreme Court held that such competition might be an important factor in determining dissimilarity of circum-

[13] 162 U.S. 184.
[14] 167 U.S. 479.
[15] 162 U.S. 197.
[16] 168 U.S. 144.

stances and conditions, and that in the instant case the Commission had failed to allow for railway competition at a trade center and junction point. Since it was almost always possible in an important case to demonstrate such competition, the effect of the decision was practically to nullify the long and short haul clause. As Justice Harlan noted, in his dissenting opinion in the *Alabama Midland* case:

the present decision . . . goes far to make that Commission a useless body for all practical purposes. It has been left, it is true, with power to make reports and to issue protests. But it has been shorn by judicial interpretation of authority to do anything of an effective character.

The Interstate Commerce Commission confessed its own helplessness in its report for the year 1897:

The Interstate Commerce Commission can conduct investigations and make reports. It can perhaps correct in a halting fashion some forms of discrimination. It collects and publishes statistical information which would be of value, if under the law it could be obtained and published within a reasonable time. But by virtue of judicial decisions, it has ceased to be a body for the regulation of interstate carriers. It is proper that Congress should understand this. The people should no longer look to this commission for a protection which it is powerless to extend.

The policy of the Interstate Commerce Act met frustration in still another direction. Implicit in the prohibition of pooling was the hope that rates might be kept "reasonable" by perpetuating competition among the railroads. Prior to the enactment of the law of 1887 railroads had frequently sought to eliminate rate cutting through the formation of pools to divide traffic or earnings among the participants. While these agreements were frequently violated because of lack of good faith among the parties, efforts to mitigate interline rivalry through agreement continued to be made. When the Act of 1887 outlawed pools, railroads turned to traffic association agreements by which they sought direct agreement in rates as well as traffic arrangements. The adoption of the Sherman Antitrust Act in 1890 and the decisions of the Supreme Court in 1897–98 in the *Trans-Missouri Freight Association* [17] and *Joint Traffic Association* cases,[18] holding these agreements illegal under the Sherman Act, appeared

[17] 166 U.S. 290 (1897).
[18] 171 U.S. 505 (1898).

to indicate that the effort to maintain competition would be successful. Actually, however, the effect of these decisions was only to accelerate the movement toward railroad consolidation.

The Interstate Commerce Commission, with rare foresight, anticipated this development. "With pooling prohibited," it noted in its *Second Annual Report,* "the tendency among the railroads seems likely to be in the direction of consolidation as the only means of effectual protection against mutual jealousies and destructive rate wars." [19] This prophecy was borne out by later events. The panic of 1893 initiated a crop of railroad failures. By June, 1894, one quarter of the total railway capitalization of the country was in receivership. The necessities of the reorganization period with its reliance on banking leadership facilitated consolidation. "During the nineties," as E. G. Campbell has pointed out:

> the railroads of the country had gone through a transition which was to be experienced by many of the other great industries of the nation in the period immediately following. At the beginning of the decade there had been innumerable great independent systems, each with its own group of subsidiaries, but each competing against rival systems in the same regions. At the end of the decade there were practically no independent systems; the various systems had been drawn into a few huge combinations which were dominated by a single man or a small group of men working in harmony with each other. . . . The railroad industry had been transformed from one dominated by hundreds of competing leaders into one controlled by a small group of financiers. . . . Throughout the country competing systems had found it more profitable to form communities of interest and co-operate instead of competing and trying to ruin each other.[20]

The concentration movement aroused considerable alarm. Speaking in 1902, Charles A. Prouty, a member of the Interstate Commerce Commission, declared:

> Five years ago the crying evil in railway operations was discrimination, mainly discrimination between individual shippers. While many rates were too high, the general level was low; and in view of competitive conditions which had for some time and then existed, little apprehension was felt of any general unreasonable advance. Not so today. The vast consolidations of the past few years; the use of injunctions to prevent departures from the published tariff; the lesson which railroad operators themselves have

[19] *Second Annual Report of the I.C.C.* (1888), p. 26.

[20] E. G. Campbell, *The Reorganization of the American Railroad System 1893–1900* (1938), pp. 331–332.

learned, that competition in rates is always suicidal, since it does not increase traffic and does reduce revenues—these have largely eliminated . . . competition. That discrimination is disappearing, but in its place comes the other danger which always attends monopoly, the exaction of an unreasonable charge.[21]

4. The Beginnings of Effective Regulation

While the Interstate Commerce Commission languished, and its inability to subject the railroads to any effective regulation became increasingly clear, the popular pressure for more effective control of the railroads increased in intensity. The Elkins Act of 1903 made departures from published railroad tariffs a misdemeanor, subjected shippers receiving rebates, as well as railroads granting them, to punishment, and provided injunctive relief to restrain deviations from the published rate. Although enacted primarily at the behest of the railroads themselves, it received popular support on the theory that it would check hidden concessions to the so-called trusts.

Rooseveltian trust-busting fervor helped to fan popular interest in checking the concentration movement. In 1904, the Supreme Court, by a narrow majority of 5 to 4, ordered the dissolution of the Northern Securities Company, a holding company which had been used by the Hill-Morgan-Harriman interests to bring two of the largest transcontinental railroad systems under common control.[22] Although James J. Hill was said to have remarked that the outcome of the suit made no difference to him except that he now had to sign two certificates instead of one, Roosevelt and the public regarded it as a great victory and pressed on to demand more effective regulation of railroad rates. In his annual message to Congress in December, 1904, Roosevelt asked that "the Interstate Commerce Commission be given the power to revise rates and regulations, the revised rates to at once go into effect, and stay in effect unless and until the court of review reverses it." The House responded by passing the Esch-Townsend Bill on February 9, 1905, by the overwhelming majority of 326 to 17, but the railroads were temporarily successful in blocking action in the Senate. The President in his message of December, 1905, again urged Congress to act, and once more the response of the House was virtually unanimous. The House on February 8, 1906, passed the Hep-

[21] *Ibid.*, pp. 333–334.
[22] *Northern Securities Co.* v. *U.S.*, 193 U.S. 197 (1904).

burn Bill which went even beyond the President's recommendations by providing that the Interstate Commerce Commission be given power to initiate as well as revise rates. The vote was 346 to 7. Again action in the Senate was delayed.

Meanwhile, the railroads had initiated a bitter fight against the projected legislation. An ambitious publicity campaign was launched with the object of persuading Congress that the public was opposed to the legislation.[23] The opposition to further control over the railroads reached its climax in the Senate, where conservatives of both parties sought to prevent the enactment of the bill. The clamor of the shippers and the widespread public uneasiness aroused by disclosures of corporate abuses and growing concentration of control at last had its effect. The conservatives in the Senate gave way and reluctantly agreed that the Commission be vested with rate-making authority; but, following familiar strategy, they insisted that the courts be given the broadest possible powers of review. Here, they were at least partially successful; the jurisdiction of the circuit courts "to enjoin, set aside, annul or suspend" the orders of the Commission was recog-

[23] The methods employed by the railroads in mobilizing opposition to the bill have been succinctly described by Professor Ripley:

"An extensive service, regardless of cost, was set up with headquarters at Washington and with branches in all the leading cities, headed by the President of the Southern Railway. Bogus conventions, packed for the purpose—such as the 'Alabama Commercial and Industrial Association'—passed resolutions unanimously, to be scattered broadcast by free telegraphic dispatches all over the country. 'Associations for the Maintenance of Property' held conventions, the fact being duly advertised. Palpably garbled news items from Washington were distributed without cost, especially during the hearings of the Senate Committee. Even more insidious and misleading methods were employed. An elaborate card catalogue of small newspapers throughout the United States was made, in which was noted all of the hobbies, prejudices, and even the personal weaknesses of the editors. . . . Magazine sections or 'ready to print' insides were also made up, in which appropriate and subtle references to railroad issues were concealed in a mass of general reading matter. Two or three weekly letters were sent gratis to minor newspapers without regular Washington correspondents, containing 'good railroad doctrine,' together with the spicy local news items. Dakota farmers got suggestions as to the danger of the proposed legislation affecting their rates. Kentucky planters were warned of the probable effect upon tobacco prices. As an indication of the formidable proportions of this campaign of education, the Chicago office, alone, employed some forty highly paid experts. Regular reports were rendered by this news service to the railroads' committee, as to the results achieved; setting forth the number of columns of news matter distributed and the changes effected in the proportion of 'pro' and 'con' items published. It was indeed a most astounding demonstration of the lengths to which organized corporate power would go to defeat regulative legislation." W. Z. Ripley, *Railroads: Rates and Regulation* (1912), pp. 496–498.

nized; railroads might obtain a temporary injunction to suspend a new rate prescribed by the Commission; the new rates were not to become operative during judicial proceedings until the order of the Commission was finally sustained by the courts.

The Hepburn Act of 1906, nevertheless, marks the beginning of effective regulation by the Interstate Commerce Commission. The size of the Commission was increased from five to seven; the tenure of office was lengthened from six to seven years; the salaries of the Commissioners were increased from $7,500 to $10,000. The jurisdiction of the Commission was broadened to include express companies, sleeping-car companies, pipe lines, railroad facilities, and various other instrumentalities of transportation such as private-car lines and industrial railroads or tap lines. Through the so-called commodity clause, the Act sought to prevent the railroads from engaging in other fields of business and to eliminate opportunities for discrimination implicit in a dual carrier-shipper status. The publicity features of the Act were made more effective by requiring thirty days' notice of all changes in rates, subject to exceptions authorized by the Commission. The sanctions against discrimination were strengthened by subjecting to stiff penalties the givers and recipients of rebates and all those departing from published tariffs. The Commission was also given power to prescribe uniform accounts and to supervise accounting and statistical practices.

The most important change was the explicit grant of a rate-making power to the Commission. It was now permitted not only to declare that existing rates were unjust and unreasonable, but to determine reasonable maximum rates for the future. While such rates could be suspended upon issuance of a temporary injunction by a circuit court, with the old rates continuing in operation pending adjudication of the controversy, the courts were directed to compel obedience if, after hearing, the order was found to have been "regularly made and duly served."

The passage of the Hepburn Act marks a significant departure in the history of railroad regulation. After nearly twenty years of evasion and frustration of regulation, the Interstate Commerce Commission was reinvigorated and the carriers were at last subjected to a reasonably effective scheme of control. From 1906 on, a steady stream of Congressional legislation widened the powers and jurisdiction of the Commission. The Mann-Elkins Act, which was passed in 1910 under pressure from the insurgents in Congress, strengthened the Commis-

sion in two important respects: it revitalized the long and short haul clause and it gave the Commission power to suspend proposed changes in rates or classifications, pending an investigation of their reasonableness. It also created the short-lived Commerce Court which was sponsored by President Taft as a court of specialized jurisdiction to improve the procedure for the enforcement of the Commission's orders. The marked tendency of that court to obstruct the Commission in the exercise of its powers led, however, to its abolition after less than three years of service.

Other important legislation affecting railroads which was passed in the pre-World War I period included the Panama Canal Act, the Valuation Act, and the Clayton Act. The Panama Canal Act (1912) strengthened the jurisdiction of the Commission over joint rail and water traffic, gave the Commission supervisory power over such water carriers as were permitted to remain under railroad control, and sought to stimulate competition between water and rail carriers by making it illegal for railroads to have interests in water carriers operating through the Panama Canal. The Valuation Act (1913) authorized the Interstate Commerce Commission to value railroad property as a basis for a more scientific determination of rates. The Act required a variety of findings as evidence of value, but unfortunately it failed to give any guidance as to the relative weight to be accorded to these findings in ascertaining fair value, and thus became a fertile breeding ground of litigation. The Clayton Act (1914), although, of course, of primary importance in the general antitrust field, also contained some carrier provisions. It reiterated the Congressional policy in favor of the maintenance of competition among railroads and provided some control over transactions between railroads and the firms with which they dealt when conditions of interlocking interest prevailed. The latter provisions, which grew out of the New Haven investigation [24] with its revelations of financial buccaneering and wastage of corporate assets, marked the first faint beginning of Commission jurisdiction over the financial management of carriers.

Each new legislative accretion increased the authority of the Interstate Commerce Commission and expanded its jurisdiction. After the passage of the Hepburn Act, the courts began to demonstrate a deference toward the Commission as "a tribunal appointed by law and informed by experience." This deference had been noticeably absent in the preceding period. The courts appeared to bow to the expressed

[24] 31 I.C.C. 32 (1914).

Congressional desire to have administrative rather than judicial regulation of railroads. Buttressed by Congressional support, the Interstate Commerce Commission succeeded in carving out a sphere of administrative autonomy which was relatively free from judicial interference.[25]

The emergence of the Commission with a recognized scope for the exercise of administrative discretion meant that that body was now in a position to become a generating source of new principles. It could give recognition to interests which had hitherto been neglected. The emasculation of the original Act of 1887 by the courts had, in effect, made the regulatory scheme prior to 1906 a harmless concession to public opinion which interfered in no important respect with the objectives and policies of railroad control and management. The reinforcing legislation initiated by the Hepburn Act and the change in court attitude which followed opened the way for other parties-in-interest to make their influence felt. The Commission's active concern with the protection of the interests of shippers and users of transportation service was demonstrated in a series of important rate decisions between 1910 and 1917, in which the Commission in the main denied permission for the rate advances proposed by the railroads. These decisions were rendered in the face of tremendous pressure on the Commission to grant the increases and in spite of marked increases in operating expenses, particularly toward the end of the period.

The impact of regulation on the railroads during these years is difficult to isolate from other factors which affected the condition of the industry. While the Commission undoubtedly exercised a restrictive effect on business pressure for increased profits, it cannot be said that the result was economic disaster for the railroads. In fact, an analysis of the available statistics indicates that the railroads, as a whole, fared better after teeth had been put into the Interstate Commerce Law in 1906 than in the years immediately preceding. The percentage of stocks paying dividends, the average rate of dividends, and the total amount of dividends all showed marked increases. While there was also a striking increase in the railroad mileage in receivership, from 4,593 in 1911 to 37,353 in 1916, rate levels and regulation had little, if anything, to do with this increase. Excessive capitalization and financial manipulation, which were outside the range of Commission control, were largely responsible for the debacles of the New Haven, the

[25] See I. L. Sharfman, *The Interstate Commerce Commission,* Vol. 2, Ch. 10, for a more extended discussion.

Rock Island, the Frisco, and various other railway systems during these years.

The railroad history of the period, nevertheless, raised crucial questions as to the future of regulation. In spite of the improved operating record in the period after 1906, the financial standing of some of the carriers appeared to be weakening. The less prosperous railroads, in particular, encountered real difficulties in attracting buyers of stock. The necessity of issuing bonds to entice investors increased the proportion of fixed-income obligations as compared with equity securities. The difficulty of obtaining new capital affected maintenance and improvements. Bankers tended to blame the hesitancies of investors and the deterioration of transportation equipment on the restrictive rate policies of the Commission and fears of what the Commission might do in the future. The defenders of regulation pointed to the financial scandals of the period as sufficient explanation for the decline in investor confidence and pressed for Commission supervision of security issues and capitalization as a means of inducing a revival of faith on the part of investors. The Commission itself was faced with a dilemma. It recognized that if large sums were to be expended on new construction and equipment, the return allowed in the form of rates had to be sufficient to induce investment in weak as well as in strong roads. Otherwise the Commission might find itself in the painful predicament of drying up the flow of capital necessary to provide the shipper with adequate service and facilities. Yet to sanction rate policies that relieved the financial exigencies of weak railroads was to add to the increment of the strong and to place the burden of watered stock, financial manipulation, inefficient management, and unfavorable location on the users of transportation service.

A restrictive policy which was confined to protecting shippers against extortion had its obvious limitations. It might impose checks upon avarice; it could not ensure adequate service, progressive railroad management, and such a development of transportation facilities as would meet national needs. It could attempt to deal belatedly with the consequences of abuses after they had revealed themselves; it could not anticipate their occurrence and plan to forestall them. The Interstate Commerce Commission had power to fix maximum rates; but the criteria which were to guide its actions were by no means clear. It lacked control over the financial structure of railroads, upon which the rate level was intimately dependent. It had no authority to prevent the flagrant financial abuses revealed in its investigation

of the New Haven, the Frisco, the Rock Island, and other railroads. It could not regulate the issuance of securities, although it had recommended that it be granted the power as early as 1907. Aside from the Safety Appliance Acts, there was a striking absence of power in the Commission to deal with railroad service as such. Railroad labor relationships were dealt with through machinery independent of the Interstate Commerce Commission. The conflicting jurisdiction of state and national authority further complicated the task of the Commission, although the *Shreveport* case [26] (1914) alleviated the situation somewhat by upholding the power of the Commission to control intrastate charges for the purpose of preventing discrimination against interstate commerce. In short, there was as yet little disposition to visualize the problem of transportation as that of developing an integrated national railroad network or to accept the view that regulation implied the responsibility of positive guidance and control as well as of negative check and veto.

5. World War I

The weaknesses of the existing system of railroad organization and control were strikingly revealed in an inability to meet the extraordinary demands of the war period in any adequate fashion. In order to overcome the difficulties growing out of conflicts of ownership and the competitive aspirations of various railroad systems, federal control and operation were proclaimed by President Wilson on December 26, 1917. The twenty-six months of federal operation of the railroads offer illuminating commentary on the potentialities as well as the limitations of railway nationalization; but because this brief experiment constituted an interregnum outside the main stream of regulatory development, the controls developed during the war will not be discussed here in any detail. War imposed its own imperatives. The primary need was unity of operation in order to secure the most expeditious movement of men and strategic materials regardless of corporate self-interest or other interfering considerations. To meet the terrific strain on the railroads, all facilities—from terminals to locomotives and freight cars—were pooled and treated as part of one system; nonmilitary passenger service was reduced; priority was accorded to freight needed for national defense; and the shortest hauls possible were employed regardless of the railroad favored. In short,

[26] 234 U.S. 342.

the War Administration took such measures as the emergency seemed to justify.

The experience of the war period did, however, exert a significant influence on the postwar regulatory pattern. For the first time the railroads of the United States were treated as a unified and integrated national system. Attention was thus directed to a new concept of regulation, a concept not merely of protecting the public against unreasonable exactions but of seeking to guide and plan railroad development in terms of more positive conceptions of national needs. If such a conception were to prevail, it was clear that the regulatory responsibilities of the Interstate Commerce Commission would have to be increased and its jurisdiction considerably widened.

The war experience also left its impress on the parties-in-interest involved in the railroad problem. The strengthened position of labor was one of the striking developments of the period. The war gave a tremendous stimulus to labor organization. Under federal operation employees were encouraged to join national labor organizations. Working rules as well as wages were determined on a national basis. Railroad labor, for the first time, appeared sufficiently strong and consolidated to be consulted in the formation of important public policies.

Investors, too, became articulate and exerted influence to make their demands felt. During the period of federal operation the railroads were operated under a guaranteed standard return to private owners of the property. Investors thus became accustomed to a guarantee of earnings, and, in looking forward to the restoration of private control after the war, they prepared to press for a continuation of legal safeguards to protect and enlarge this return.

For shippers, the war period brought increases in rates, but a large part of the burden of mounting operating expenses was borne by the general taxpayer. The strain which extraordinary war demands placed on the transportation system brought home to shippers the importance of adequate service and facilities. In shaping a national transportation policy for the postwar period, they were prepared to press for a recognition of these needs as well as protection against excessive and discriminatory rates.

Railway management, while believing staunchly in the superior virtues of private operation, found itself inducted into the public service for the period of federal control. The assumption of the duties and responsibilities of public officials compelled them to take a wider view of the transportation problem than that derived from the tradi-

tional business outlook of the individual companies. The experience of federal operation, while by no means converting management to support of nationalization, created an understanding and an appreciation of the problems of regulatory authorities which had not been previously in evidence.

6. The Transportation Act of 1920 and the Postwar Years

It is against the background of this experience that the Transportation Act of 1920 emerged. At the time, "back to normalcy" sentiment was running strong. A violent reaction against war controls was under way. Whether justified or not, there was a disposition to criticize government operation during the war as woefully inefficient. Business interests attacked the policy of the War Administration as unduly favorable to labor. The proposals of Director-General McAdoo and his successor, Walker D. Hines, to extend the period of federal operation for a five-year period were impatiently brushed aside. The Plumb Plan, which was sponsored by the railroad brotherhoods, and which provided for ownership of all railroads by the United States government and operation by a federal corporation with a board of fifteen directors, of which five were to be named by the President, five elected by the operating officials, and five chosen by the classified railroad employees, met with little response outside of labor ranks.

Yet it is significant that practically every proposal sponsored by groups interested in the restoration of private operation, whether investor, management, or shipper, also contemplated a considerably expanded field of public control. The Warfield Plan, which represented the views of the National Association of Owners of Railway Securities, provided for Commission supervision over issuance of securities and over the expenditure of the proceeds. But it also demanded a statutory rule prescribing that rates produce not less than a 6 per cent return on the aggregate railroad property investment in each of three classification territories. A recapture plan was suggested by which the earnings of each road in excess of 6 per cent would be divided, one third to go back to the road, and two thirds to go into an excess earnings fund, to be divided between labor and such general improvements in transportation service as the Commission found to be in the public interest. The consolidation of railroads was to be permitted, conditional on Commission approval.

The Plan of the Railway Executives also favored consolidation of existing lines into strong competitive systems; it made provision for joint use of equipment and terminals, when the Commission found such action to be in the public interest. Railway executives agreed that the Interstate Commerce Commission be given power over security issues; they favored a statutory rule that would ensure "a fair return on fair value," but they opposed any scheme for the recapture of excess earnings.

The Plan of the Transportation Conference called by the United States Chamber of Commerce went even further. This scheme provided for compulsory consolidation by a Federal Transportation Board if, after a five-year period, voluntary action failed. It proposed federal incorporation of railroad companies with minority representation of employees and shippers in the directorates; federal regulation of security issues; a statutory rule providing a 6 per cent return on fair value, with a contingent fund to support the credit of weak railways; and the creation of a federal transportation board in addition to the Interstate Commerce Commission, to promote the development of a national system of railway, water, and highway transportation.

The Interstate Commerce Commission also made recommendations. It agreed with the representatives of management, shippers, and investors that the railroads be restored to private ownership and operation. But it called for a considerable strengthening of its own authority—broad power over the rate structure; power to determine division of rates between carriers; power to regulate water carriers; power to control consolidations, joint use of facilities, and the pooling of freight earnings; power to authorize additions, extensions, and the construction of new lines; power to control security issues and capital expenditures; and power to adjust conflicts between federal and state jurisdiction.

THE SCOPE OF THE ACT OF 1920

Out of the maelstrom of these proposals, the Transportation Act of 1920 emerged. In accordance with the dominant sentiment of the times, it provided for a return to private ownership and operation. Labor's Plumb Plan was rejected. Other parties-in-interest found more comfort in the content of the Act. Investors were not granted the guarantee of earnings which some of them demanded, but a variety of provisions in the Act were designed to safeguard their

interests. The Commission was given control over railroad security issues and assumptions of obligations by railroads with respect to the securities of other railroads. The Commission was also authorized to supervise the uses to which the proceeds of security issues were put.

The rate-making powers of the Commission were extended to include the fixing of minimum as well as maximum rates. Section 15A of the Act proclaimed a statutory rule of rate making:

In the exercise of its power to prescribe just and reasonable rates the Commission shall initiate, modify, establish or adjust such rates so that carriers as a whole (or as a whole in each of such rate groups or territories as the Commission may from time to time designate) will, under honest, efficient and economical management and reasonable expenditures for maintenance of way, structures and equipment, earn an aggregate annual net railway operating income equal as nearly as may be, to a fair return upon the aggregate value of the railway property of such carriers held for and used in the service of transportation: Provided, that the commission shall have reasonable latitude to modify or adjust any particular rate which it may find to be unjust or unreasonable, and to prescribe different rates for different parts of the country.

The Commission was ordered to determine the aggregate value of railways and was authorized to use the results of its investigations under the Valuation Act of 1913 for this purpose. It was also to determine what constituted a fair return on the value of property; Congress specified, however, that for the first two years after the passage of the Act the rate of return was limited to 5½ per cent, to which the Commission might add an additional ½ per cent to provide for improvements and betterments. Thus, an affirmative obligation was imposed on the Commission to make provision for the revenue needs of the railroads.

In addition, in order to take care of the special needs of the so-called weak roads, a "recapture" clause was included in the Act. A carrier earning in excess of 6 per cent of the value of its property was required to divide the excess equally between a "reserve fund" designed to stabilize its own financial position and a "general railroad contingent fund," which was to be used by the Commission to make loans, or to lease equipment to carriers "in furtherance of the public interest in railroad transportation." The Commission was also given power, in determining divisions of joint rates, to take into consideration, among other factors, the revenue requirements necessary to provide a fair return on the value of the property. These provisions,

taken in conjunction with the instruction to the Commission to formulate a consolidation plan which would establish a limited number of systems, each earning substantially the same rate of return, were designed to provide special protection for the investor in the "weak" roads and to ensure adequate revenue for all.

At the same time an effort was made to carry out the Interstate Commerce Commission's recommendations for an "emancipation of railway operation from financial dictation." The prohibition of interlocking directorates, except with Commission consent, the provision making it unlawful for officers or directors of carriers to profit from dual railroad and banking connections, and the authority of the Commission to regulate acquisitions of control, consolidations, and security issues, were designed to prevent the exploitation of carriers by financial control groups having interests at odds with those of the carrier itself. That the effort should have been made is significant. That it was to prove less than successful was, perhaps, not unexpected.

Shippers found the service provisions of the Act most to their liking. The Commission was given wide authority in the field of service regulation. Carriers were required to furnish safe and adequate service; the Commission might fix penalties or other sanctions for nonobservance of its service regulations. Voluntary extensions and abandonments as well as proposals for new construction were made subject to the Commission's approval; the Commission might, in addition, order a carrier to acquire facilities or build an extension where the public interest, convenience, or necessity justified such action.

Managerial discretion appeared to be limited by the extension of the Commission's jurisdiction. Yet in some respects the opportunities for managerial initiative were widened. Where pooling agreements had been previously declared illegal, they might now be validated with the consent of the Commission. The Commission was authorized to prepare a comprehensive consolidation plan, but it had no statutory power to force its scheme upon management. The initiative in consolidation still remained with the carriers. Piecemeal consolidation by two or more railroads was dependent upon Commission approval, but control through the noncarrier holding company was not subject to Commission jurisdiction. The rate-making provisions of the Act were viewed as an improvement over previous legislation, although the provisions for recapture of excess earnings were resented by the executives of strong roads.

The Transportation Act of 1920, taken as a whole, represented a striking departure in railroad regulation. The earlier railroad laws had been dominated by the memory of railroad abuses; they were designed to protect shippers and other members of the consuming public against extortionate or discriminatory charges. The 1920 legislation abandoned this "restrictive" approach; while continuing the earlier mandate that rates should be "reasonable and just," it gave explicit recognition to the needs of the carriers for adequate revenue. By offering protection to the investor, it sought to stabilize railroad credit and stimulate a flow of capital into the industry which would ensure the maintenance of an adequate transportation service. The statutory recognition which was thus given to the long-standing demands of the carriers helped to neutralize the opposition which might otherwise have developed to the enlarged jurisdiction of the Interstate Commerce Commission.

The range of authority vested in the Interstate Commerce Commission by the Act of 1920 appears impressive. Its power to fix minimum as well as maximum rates included express legislative authorization to prescribe intrastate rates where such action was necessary to remove discrimination resulting from state action. It was given broad powers to supervise the financial structure of railroads as well as extensive authority over service facilities. The membership of the Commission, which had been increased from seven to nine in 1917, was now further increased to eleven. Armed with its new powers, the Commission seemed to be in a position where it could supervise practically all of the important activities of the railroads and work out "a permanent solution of the railroad problem."

WEAKNESSES

In fact, these hopes proved illusory. "Permanent solutions" cannot be shaped to meet the needs of a dynamic society, and regulatory controls, unless they can be flexibly adjusted to meet changing needs, run the danger of becoming strait jackets. The Transportation Act of 1920 was in many ways ill adapted to cope with the technical and economic changes which have dictated the fortunes of the railroad industry in the years since 1920. Legislation based on the theory that the railroads had a virtual monopoly of transportation was soon outmoded by the rapid growth of alternative transportation agencies—motor carrier, water carrier, and even airplane competition. Statutory standards that breathed in every pore the hope for industry stability

were confronted with a crumbling business fabric, even before the disastrous repercussions of the 1929 panic produced complete demoralization.

Under these circumstances, the predicament of the Interstate Commerce Commission was not a happy one. In the years of relative prosperity from 1920 to 1929, the incidence of the growth of competitive transportation agencies was somewhat obscured; the Interstate Commerce Commission could still hope to arrange a composition among the parties-in-interest in railroading which would yield general satisfaction. But, as the full impact of the depression was felt and the inroads of other modes of transportation became more apparent, the Interstate Commerce Commission was faced with an increasingly unfavorable milieu for a successful composition of interests. The task of a regulatory agency which is compelled to deal with a declining industry in a period of marked economic instability is never an easy one.

Nor was the Interstate Commerce Commission particularly well equipped to meet the challenge which these new conditions offered. Its power over water competition was limited. It had no authority over motor and air carriers. The effort made in 1920 to bring water carriers under the complete jurisdiction of the Interstate Commerce Commission had been defeated. A proposal to subject interstate motor carriers to Interstate Commerce Commission regulation was apparently seriously considered by Chairman Esch of the House Committee on Interstate and Foreign Commerce, but he was dissuaded from attempting to incorporate it in the Transportation Act of 1920 as a result of "a good deal of opposition from motor-truck companies, motor manufacturers, traffic men, and others." [27] Witnesses before the committee did not envisage the highway carrier as a serious competitor for the railroads. Professor Emory Johnson testified that "the shipper [of package freight] will probably make his short shipments—up to, say, 25 miles—preferably by motor truck," but he expected that highway carriers "would be used, with decreasing frequency, under special conditions, up to several hundred miles." [28] Expert testimony and the opposition of interested groups discouraged regulatory action.

[27] Hearings, House Committee on Interstate and Foreign Commerce, *Return of Railroads to Private Ownership* [Transportation Act, 1920], 66th Cong., 1st Sess. (1919), Vol. 1, p. 292.

[28] *Ibid.*, p. 294.

The Interstate Commerce Commission was thus hampered at the start by a lack of comprehensive jurisdiction over alternative modes of transportation. It could control the activities of the railroads in resisting the incursions of their competitors; it had no direct power over the tactics of the competitors themselves. As the competition of water and motor carriers became acute, and as the railroads at last awakened to the menace, the Commission was necessarily faced with pressure for rate adjustments which would enable the railroads to meet the threat of diversion of traffic to their rivals. If the Commission sanctioned such adjustments, it risked disrupting the rate structure and throwing the major burden of sustaining railroad earnings on noncompetitive traffic. Whole localities, regions, and industries might thus find themselves disadvantaged. If it resisted the adjustments, it found itself in a position where it appeared to be accelerating the diversion of traffic from the railroads to their competitors. The choice of policy in either case was a difficult one to make; it was made infinitely more difficult by the fact that the Commission's control of competitive transportation relationships was partial and incomplete.

THE CONSOLIDATION EXPERIENCE

Absence of authority also hampered the work of the Commission in other spheres. The consolidation powers of the Commission were a notable example. The Transportation Act of 1920 envisaged a regrouping of the railroads of the country into "a limited number of systems." The Commission was instructed to draw up a comprehensive plan. The Act established a number of criteria to guide the Commission in formulating its scheme. Competition between systems was to be preserved as fully as possible; existing routes and channels of trade were to be maintained, wherever practicable; the systems were to be so arranged as to equalize rates of earnings. The object was to simplify rate making, achieve economies, and support railroad credit generally by combining weak with strong roads. But no compulsory power was given to the Commission to put its plan into effect. Acceptance by the railroads was to be voluntary. The apparent hope was that the weak would be willing and the strong would be altruistic.

Pending the adoption of a "comprehensive plan," railroads seeking to acquire control of other railroads were required to obtain the consent of the Commission. Commission approval of such piecemeal consolidation was conditional on a finding that the acquisition would

be in the public interest. The authority of the Commission extended to control of one carrier by another. But under the Act of 1920 it did not extend to cases where noncarrier holding companies were utilized as instruments for the unification of carrier properties. The effect of this loophole in the Act was to reserve actual power over consolidation to the railroad control groups and their affiliated banking connections. As a result, most of the real activity in the way of consolidation during the twenties took place on a level which was immune from Commission control. The Commission went through the motions of formulating a "comprehensive" plan. It held elaborate hearings, accumulated volumes of testimony, and, finally, with marked reluctance—and only in order to comply with the Congressional mandate—it announced a plan which, under the circumstances, could have little practical significance. As a result, actual activity in the consolidation field during the twenties continued on the plane of traditional competitive strategy.

The struggle for traffic was the dominating consideration. Rival railroad systems sought to extend their traffic control by gobbling up strategic neutral roads. Other systems which found their interests endangered by the threatened diversion of traffic were forced to join in the battle. Corporate imperialism manifested itself in the form of competitive bidding for control of the so-called "neutral" lines. The struggle for control frequently involved extravagant expenditures, and it made reliance on banking support essential. With the boom market of the late twenties, it became possible to dispose of railroad holding company securities to investors at attractive prices in spite of doubts about the future of the industry. Holding company affiliates like the Van Sweringens' Allegheny Corporation and the Pennsylvania Railroad's Pennroad Company were quick to take advantage of the situation. Thus, the war chests of the contestants were replenished, and a further impetus was given to wasteful rivalry while the Interstate Commerce Commission stood by helplessly. With the depression came the debacle; the Van Sweringen empire collapsed; holding company securities shrank in value. In 1933 the noncarrier holding company was at last brought within the Commission's jurisdiction, but, by that time, most of the damage had been done. The consolidation provisions of the Transportation Act of 1920 had demonstrated their futility.

This discussion suggests that the Commission was by no means as well equipped to cope with the realities of business practice and the

sweeping changes of the twenties and thirties as a cursory catalogue of its extensive powers might indicate. The Commission had to operate within the limits which the law imposed on it. It had no roving mandate to strike at abuses wherever it found them, when specific authority to do so was lacking. It could, and did, make recommendations to Congress to supplement its authority when weaknesses in the law were revealed. But it could not compel action when Congress chose to deny it power.

To understand the regulatory process as it operated in the years from 1920 to 1929, a comprehension of the setting within which it was functioning is essential. The climate of opinion was not favorable to aggressive regulatory action. The prevailing sentiment of the time glorified private business enterprise; the dominant political forces were unusually tender in their solicitude for vested rights. Some of this solicitude injected itself into the Transportation Act of 1920 in the requirement that the Interstate Commerce Commission permit, as nearly as possible, a fair return on the value of the property. It was reflected in decisions of the Supreme Court construing the Act when occasional forays of the Commission threatened interference with the prerogatives of management and control. It expressed itself in the attitude of the Commission itself in a tendency to let well enough alone, and in a reluctance to assume an active role in guiding railroad destinies or to interfere, in any substantial fashion, with what was termed "managerial discretion."

THE RATE STRUCTURE

The period from 1921 to 1929 was characterized by extensive and profitable business activity. There were depressed sectors of economic life; agriculture failed notably to share in the general prosperity; but, on the whole, after the depression of 1921, there followed a period of tremendous upsurge and expansion. The aggregate earnings of the railroads failed to keep pace with the general improvement but, compared with what was to follow, if not with what went before, the period might fairly be described as one of relative prosperity for the railroads. This "relative prosperity," in fact, served to a considerable extent to conceal the economic effects of the inroads of competitive transportation agencies. Passenger revenue shrank considerably during the period as a result of the increased use of the automobile; freight revenue, on the other hand, continued to increase.

The Transportation Act of 1920 had attempted to give protection

to investor and carrier interests by instructing the Commission to provide a rate level that would maintain the statutory fair return. In exercising this mandate, the Commission in 1920 attempted to meet the revenue needs of the carriers by granting a 33 per cent increase in freight rates. Shipper opposition was brushed aside. The year 1921 turned out to be a depression year and, as a result of a considerable decline in traffic, the net railway operating income of Class I roads provided a rate of return of 3.44 per cent.[29] At the same time, other industries were also affected by depression; commodity prices generally had registered substantial declines and shippers complained of the unreasonable level of transportation charges. As a result of shipper pressure, and prospects for an upward trend in the volume of traffic during 1922, the Commission ordered the General Rate Decreases of 1922 involving rate reductions of approximately 10 per cent. The result for 1922 was a rate of return of 4.31 per cent; by 1923 the rate of return had increased to 5.18 per cent. It remained above 5 per cent through 1929, reaching highs of 5.96 per cent in 1926 and 5.90 per cent in 1929.

From the general investor's point of view, the situation during these years appears to have been regarded as reasonably satisfactory. Between 1920 and 1929, as Sharfman has pointed out, "the position of the carriers was showing continual improvement; investment in plant and facilities had increased by about $5,500,000,000; corporate surplus had increased by more than $2,300,000,000; the amount of stock-yielding dividends had increased by almost $2,500,000,000; the average rate on dividend-paying stock had increased from 6.52 per cent to 7.47 per cent, and the average dividend rate on all stock had increased from 3.74 per cent to 5.70 per cent." [30] While this improvement was impressive, it remains true that, even in the boom year of 1929, more than 23 per cent of the railroad stock outstanding did not pay dividends, and that during the twenties some of the weaker railroads were forced into receivership.

The recapture plan had been developed to meet the problem of the weak railroads, but it proved ineffective. Although the plan itself was upheld as constitutional in the *Dayton-Goose Creek Railway* case [31] (1924), the valuation criteria used by the Interstate Com-

[29] This percentage computation is based on the method of valuation employed by the I.C.C. in *Excess Income of St. Louis and O'Fallon Ry. Co.*, 124 I.C.C. 3 (1927).

[30] I. L. Sharfman, *The Interstate Commerce Commission*, Vol. III B (1936), pp. 172–173.

[31] 263 U.S. 456.

merce Commission in determining recapture were challenged in the *O'Fallon* case[32] (1929) and rejected by the Supreme Court. Recapture implied a prior valuation by the Commission that the courts would accept. Pending such a determination, carriers refused to pay or paid under formal protest. The result, up to December 17, 1931, was that less than $11,000,000 was paid, most of it under protest, although the Commission's estimates of the amount due for the 1920–30 period was in excess of $359,000,000.

Apart from the difficulties of enforcement, the recapture experiment developed unexpected results. As the law was framed, it took excess income in good years but made no allowance for failure to earn a fair return in bad years. The weak railroad which enjoyed a brief period of good business, or which had an inflated capital structure but a small physical valuation, might find itself subject to recapture. The strong railway which chose to increase its operating expenses instead of its income might avoid recapture. These anomalies, as well as the endless litigation, served to discredit the experiment. With the onrush of depression and the disappearance of surplus, the recapture clause was retroactively repealed by the Emergency Transportation Act of 1933. Thus, the problem of the investor in the weak railroad remained unsolved during the twenties. Though the investor interest in general enjoyed a reasonably satisfactory status, the fair return contemplated by the Act of 1920 was not earned on all roads.

The position of the Commission was difficult. In extending protection to carriers and investors, it was necessarily forced to repulse the demands of shippers and users for lower rates. Such a policy was calculated to make the Commission unpopular with politically potent groups. Denied relief by the Commission, such groups turned to the legislative and executive arena for redress—and sought to accomplish indirectly what could not be accomplished directly.

The tactics of agrarian groups during these years furnish an excellent illustration. The decline in the price of farm products after 1920 led farmers to seek lower freight rates in order to improve their position. The 10 per cent general reduction of 1922 still left them dissatisfied. Appeals to the Commission for relief were rejected. The agricultural interests then turned to Congress. Under pressure from the farm bloc a compromise was arranged, and on January 30, 1925, Congress passed the Hoch-Smith Resolution. The Resolution

[32] 279 U.S. 461.

declared: "That it is hereby declared to be the true policy in rate making to be pursued by the Interstate Commerce Commission in adjusting freight rates, that the conditions which at any given time prevail in our several industries should be considered in so far as it is legally possible to do so, to the end that commodities may freely move." The Resolution then directed the Commission to investigate existing rates and correct defects disclosed. "In view of the existing depression in agriculture," the Commission was ordered "to effect with the least practicable delay such lawful changes in the rate structure of the country as will promote the freedom of movement . . . of the products of agriculture . . . at the lowest possible lawful rates compatible with the maintenance of adequate transportation service."

On March 12, 1925, the Commission, bowing to the Hoch-Smith Resolution, ordered a comprehensive investigation of rate structures. The Western carriers thereupon seized the initiative and sought a general rate advance. Thus the Commission found itself, as it had remarked earlier, "confronted with the demands of shippers, on the one hand, for reductions in rates which they allege are excessive and out of all proportion to the fallen value of commodities . . . and, on the other hand, with the fact that the carriers have not been receiving the fair return contemplated by Congress." [33]

The Commission's first move was to deny the proposed rate advances. Thus, the *status quo* was at least maintained, pending the outcome of its general investigation. But no general reduction of agricultural rates was ordered. In 1927, in a case dealing with rates on deciduous fruits from California to Eastern markets, the Commission recognized the force of the Resolution and ordered a reduction in rates.[34] The carriers appealed, and the Supreme Court upheld the appeal in *Ann Arbor Railroad* v. *United States* [35] (1930). The Court pointed out that the Resolution "does not purport to make any change in the existing law, but, on the contrary, requires that that law be given effect. . . ." In the Court's view, the Resolution was "more in the nature of a hopeful characterization of an object decreed desirable if, and in so far as, it may be attainable, than of a rule intended to control rate making." Thus, by a process of judicial construction, the Resolution was robbed of any controlling

[33] *Annual Report of the I.C.C.* (1921), p. 6.
[34] 129 I.C.C. 25.
[35] 281 U.S. 658.

effect and dismissed as a meaningless Congressional gesture.[36]

While the net result of agrarian pressure, in this instance, was a failure to get results in the form of rate reductions, in other instances shipper pressure proved more potent. The most effective form of pressure was that exerted by shippers and users, who could turn to cheaper modes of transportation. Faced with such bargaining power, the railroads were usually forced to make concessions and to plead for Commission recognition of the necessity. The relief granted in such instances was a response to carrier demands as well as shipper pressure. Such piecemeal whittling away of parts of the existing freight structure necessarily complicated the task of the Commission in arranging satisfactory adjustment of the rate level as a whole. Existing relationships between industries, localities, and sections were disturbed. Noncompetitive traffic was penalized, since the railroads naturally sought to recoup their fortunes on that portion of the traffic which could not easily be diverted to rival transportation agencies. The result was frequently to stimulate political agitation as groups dissatisfied with the Commission's decisions turned to Congress or the Chief Executive's appointive power to find a remedy for their grievances. Thus, the dissatisfaction of the intermountain states with a transcontinental rate structure that favored the Pacific coast and discriminated against intermountain territory led to demands for representation on the Commission and for the enactment of various bills which were designed to secure a rigid enforcement of the long and short haul clause. The carriers, on the other hand, demanded repeal or such modification of the long and short haul clause as would enable them to meet water competition effectively without disturbing the existing level of rates at intermediate points.

[36] The subsequent history of the Resolution belongs to the depression period. As a result of data produced in the investigation growing out of the Resolution, the Commission in 1930 ordered reductions in grain rates. As a result of delay encountered in calculating the new tariffs, the effective date of these reductions was postponed until the next year. The carriers petitioned for a rehearing—this was denied. An appeal was then taken to the courts. In January, 1932, the Supreme Court ordered a rehearing. The result has been summarized as follows:
"So by the time the farmers, afflicted by one depression, had raised enough political stir to obtain legislative relief and had pursued their remedy through administrative red-tape, a whole economic cycle had swung around and another depression was with us. This time the carriers found public sympathy and took advantage of it to get release in the courts from the small part of the burden that the farmers were about to shift upon their shoulders." H. C. Mansfield, *The Lake Cargo Coal Rate Controversy* (1932), p. 256.

Even where competitive modes of transportation were not involved, conflicts between rival interests for favorable treatment at times generated political pressures which transformed the Commission into a football of politics. Of these, perhaps the most famous was the Lake Cargo Coal Rate Controversy.[37] Here, the rivalry between coal operators in the Northern and Southern fields to supply lake cargo coal and the pressure for preferential freight rates to Lake Erie ports were so intense as to lead to direct political interference with the rate-making process. Appointments were made and rejected with a view to swaying the decision of the Commission. The Commission itself was hopelessly divided, finding for the Southern operators in 1925 and for the Northern operators in 1927. Appeals were taken to the courts; finally, a compromise was worked out among the railroads concerned, more or less independently of both the Commission and the coal operators. The Commission emerged from the battle "somewhat battered and scarred," content to remain a spectator while the rival gladiators arranged a truce.

The whole controversy illustrated in remarkable fashion the operative limits on the Commission's rate-making powers when confronted with business and political realities. Intimately involved as the Commission is in the stress of competition between industries and localities, and endowed with powers which make it at least potentially an arbiter of economic destinies, it dares not intervene to direct economic developments in too positive a fashion without arousing intense political resentment. The safest course it can pursue is frequently one of relative noninterference. Hence, the tendency in crucial cases is often to seek to preserve the *status quo* or to let the parties in controversy work out a mutually satisfactory compromise where that is possible. In putting its seal of approval on such solutions, the Commission seeks to ensure itself against attack and to avoid being dragged into the abyss of political controversy.

THE ADJUSTMENT OF INTERESTS (1920–29)

The adjustment of interests which evolved from the operation of the regulatory process in the years from 1920 to 1929 can now be briefly summarized. The program for the "emancipation of railway operation from financial dictation" turned out, on the whole, a failure. Railway security issues were subject to supervision, but financial control groups succeeded in discovering legal and other subterfuges

[37] See H. C. Mansfield, *The Lake Cargo Coal Rate Controversy* (1932).

which rendered them largely immune from Commission jurisdiction. Management continued to be dependent on the policy of the control groups; the consolidation developments of the period were determined, not by the Interstate Commerce Commission or by the needs of the weaker railroads, but by the stronger railroads and their affiliated investment bankers. The effects, in so far as extravagant expenditures for stock purchases and widespread distribution of dubious holding company securities were involved, were shortly to prove disastrous for many small investors.

On the other hand, investors in railroad securities, taken as a whole, fared reasonably well. While the rate of return deemed by the Commission to be fair was not earned, the railroads as a group "enjoyed a credit position well above the average of corporate industries generally" and "were able to attract capital in a volume at least proportional to their importance in the national economy." [38] Investors, in other words, found the earnings of the railroads during the period sufficiently attractive to bid freely for the privilege of buying railroad securities. The flow of capital into the industry—which totaled in the neighborhood of $6,000,000,000 in spite of the fact that railroad growth had passed its peak—was calculated to yield considerable satisfaction to the suppliers of railway equipment and materials.

The impact of the regulatory process on shippers and other users is more difficult to evaluate. From 1922 on, the level of freight rates was relatively stable; the Interstate Commerce Commission maintained the *status quo*. Farmers, suffering from the prolonged agricultural depression, pressed for rate reduction, but without effect. Other shippers used the threat of abandoning the railroads for other transportation agencies, in order to obtain concessions. Passengers abandoned the railroads in considerable numbers.

Railroad labor, as a whole, declined in influence after 1920, compared with the war period. The major wage-rate increases occurred between 1915 and 1920. In the last year, the railroad wages bill reached a high of $3,754,000,000; employment a peak of over two million. Following a wage cut and a decline of employment in 1921, the wage bill shrank to $2,824,000,000. Another wage cut the next year brought the total compensation down to $2,693,000,000. From 1923 to 1929, the total wage bill was stabilized around $2,900,000,000 annually. Traffic meanwhile increased, but the increased traffic was moved by a steadily declining number of workers. By 1929, the average number of em-

[38] H. G. Moulton, *The American Transportation Problem* (1933), pp. 47, 48.

ployees had fallen to 1,661,000, or almost 200,000 below the average for 1923. "In terms of gross ton miles of freight and passenger car movement, output per man grew by 36 per cent between 1923 and 1929. . . ." [39] A shrinking labor force, in other words, was yielding an increasing output.

7. The Impact of Depression

With the onset of economic depression in 1929, the railroad industry took a sharp turn for the worse. Freight revenue declined from $4,-826,000,000 in 1929 to $2,451,000,000 in 1932; for the corresponding years, passenger revenue shrank from $874,000,000 to $377,000,000 while total operating revenue dropped from $6,280,000,000 to $3,127,-000,000. In 1929 the railroad net income, after provision for fixed charges, totaled $896,800,000; by 1931 it had declined to $134,800,000. In 1932 Class I carriers as a whole "failed to earn their fixed charges . . . by more than $152,000,000; carriers operating approximately 74 per cent of the total mileage of Class I roads failed in that year to earn their fixed charges by more than $250,000,000." [40] The credit of the railroads was virtually destroyed. Expenditures for maintenance declined sharply. The number of employees dropped from 1,661,000 in 1929 to approximately a million in 1932; the total wage bill shrank from $2,900,000,000 to $1,513,000,000 in the same period.

The regulatory process was thus compelled to operate in an environment of sharp economic contraction. The impact of depression was severely felt by all parties-in-interest in the industry. The natural reaction of the more powerful interests was to seek to shift the burden of readjustment and sacrifice to the weaker interests. In the first phase of the depression, the financial control groups and management, operating apparently on the assumption that the economic disturbance would pass quickly, made it their policy to maintain dividends, so far as possible. In 1929, $441,000,000 were paid out in dividends (eliminating intercorporation payments); in 1930, the total increased to $492,000,000; in 1931, it dropped to $311,000,000. Railroad employment in the same period declined from 1,661,000 to 1,259,000; the wage bill, from $2,897,000,000 to $2,095,000,000.

As the gravity of the decline became apparent, the carriers turned to the Interstate Commerce Commission for relief. In June, 1931,

[39] H. G. Moulton, *op. cit.*, p. 221.

[40] I. L. Sharfman, *The Interstate Commerce Commission*, Vol. III B (1936), p. 198.

they filed an application for a horizontal 15 per cent increase in freight rates. Railroad security holders joined in supporting the application. They pointed to the threat to railroad credit and contended "that the granting of a rate increase is the only practicable method of meeting the existing and immediate emergency, and that no other method had been suggested." Shippers representing a great variety of industries protested; they pointed out that financial distress was not confined to the railroad field, that prices in other areas had fallen drastically, that railroad rates had shown no corresponding decline, and that an increase would place a drastic burden on industry and agriculture which would accelerate the movement to divert traffic to other carrier agencies. In the light of the evidence submitted, the Commission decided to deny the 15 per cent increase. It did, however, approve as an emergency measure a number of rate advances that at the time were expected to yield an increased revenue of between $100,000,000 and $125,000,000 a year.[41] The rate increases authorized were designed primarily to aid the most needy carriers; the carriers were required by the Commission to submit a plan "for the marshalling of the fund derived from the increase authorized, and for the distribution of that fund in the first instance among the carriers who fail to earn their interest charges, in proportion to their deficiencies." The Railroad Credit Corporation, a private corporation controlled by the carriers themselves, was organized to carry out this scheme. Because of a further shrinkage of traffic, the emergency rate increases did not yield the revenue anticipated. The total up to March 31, 1933, when the original order expired, was $75,425,428; out of this amount the Railroad Credit Corporation during the same period made loans to the extent of $73,691,368. These loans helped to prevent some defaults, but the resources of the corporation were hardly adequate to cope with the desperate situation in which the railroads found themselves.

The next step in the program for the rehabilitation of the railroads was the establishment of the Reconstruction Finance Corporation, early in 1932. That agency, among its other functions, was to make loans to aid the temporary financing of the railroads and receivers of railroads. Loans were to be extended only if the directors of the corporation found that funds were not obtainable on reasonable terms through ordinary banking channels, if the Commission gave its approval, and if the loans were "adequately secured." Up to Decem-

[41] See *Fifteen Per Cent Case,* 178 I.C.C. 539 (1931).

ber 31, 1932, loans to the amount of $337,435,100 were authorized. Of this total more than $100,000,000 went to meet maturing funded debt, $74,000,000 to meet interest on funded debt, $61,500,000 for construction and repairs, nearly $38,000,000 to repay bank loans, and the rest for miscellaneous purposes. The intervention of the Reconstruction Finance Corporation provided a prop to support a rapidly crumbling financial structure. Public credit was thus mobilized to salvage the stake of the investor.

A third step in sustaining the financial position of the railroads was the reduction in labor costs. As the depression deepened, railroads made drastic cuts in their labor force. On December 31, 1931, the carriers served notice on their employees of their intention to reduce rates of pay 15 per cent. This the employees refused to accept, but as a result of an agreement made in January, 1932, the Railway Labor unions were prevailed upon to accept a 10 per cent cut for twelve months ending January 31, 1933.

In short, up to 1933, the campaign to save the railroads involved essentially an effort to shift the burden of depression readjustments to labor and the consumer of railroad service, although suppliers of railway material also suffered severely due to the curtailment of maintenance and purchase of equipment. All parties-in-interest were compelled to make sacrifices as the result of the catastrophic decline in earnings. Public policy, however, approached the problem primarily from the point of view of the investor and financial interests concerned. The increase granted in freight rates and the intervention of the Reconstruction Finance Corporation were primarily motivated by the need for financial stability and the necessity for safeguarding investors' interests.

8. New Deal Transportation Policy

With the change of administration in 1933, this policy was modified. A shift in the community balance of power took place. Labor interests found more articulate and effective expression. Shippers' interests, particularly of an agricultural character, became somewhat more influential. Investors' interests were compelled to face sacrifices, but public policy made an effort to distinguish between the interests of financial control groups and small investors in favor of the latter. Legislation was fostered to curb the power of financial control groups and to protect small investors from exploitation by them. At the same

time, the new administration sought to aid the position of the railroad industry generally by bringing competitive modes of transportation under more effective control.

These currents are clearly discernible in the flow of public policy since 1933. The legislative impulse to subject the financial control groups to more effective supervision found expression in an amplification of the powers of the Interstate Commerce Commission. The Emergency Railroad Transportation Act of 1933 gave the Commission jurisdiction over noncarrier holding companies, when used as instruments for the acquisition of control in the railroad field. By closing this gap in the Act of 1920, the Commission was at last vested with some power to ensure that future unifications of railroad property would be in furtherance of its own views on consolidation rather than be determined by the dominating ambitions of rival railroad financial interests.

The desire to impose limits on the powers of finance is also discernible in the railroad reorganization legislation of the period. Under the system of equity receiverships which prevailed prior to 1933, financial abuses were common. Excessive fees to receivers, protective committees, reorganization managers, and counsel made deep dents in the debtor's estate. Financial control groups frequently dominated the reorganization process, and the rights of the body of small investors went unprotected. The Interstate Commerce Commission's control over reorganization was, at best, remote, indirect, and exercised at a late stage in the proceeding. After the reorganization plan had been approved by the Court, the new corporation formed to take over the railroads had to request the permission of the Interstate Commerce Commission to issue securities. The Commission had the right to refuse permission, but such refusal meant that after months and sometimes years had been spent in developing a plan the proceeding would have to start all over again. "As a result of this condition the Commission approved many securities issued under plans of reorganization of which it disapproved—solely for the purpose of preventing further delay." [42]

Dissatisfaction with the old system of equity receiverships was widespread when the depression threatened a new holocaust of railroad reorganizations. With the decline in earnings and the inability of many railroads to meet their fixed charges, the necessity of read-

[42] C. S. Rhyne, "Work of the I.C.C. in Railroad Reorganization Proceedings under Section 77 of the Bankruptcy Act," 5 *George Washington Law Review* 754 (1937).

justments in the capital structure which would scale down fixed charges became manifest. In the closing days of the Hoover administration, Section 77 of the Bankruptcy Act (signed March 31, 1933) was enacted to meet the need. The statute was drafted hurriedly, and experience in its administration revealed many defects. As a result, Section 77 was substantially amended in 1935; it still offers many opportunities for delay.

Under the new reorganization procedure, the Commission plays an important and active role at an early stage in the proceedings. The Commission must ratify the appointment of trustees; it fixes maximum limits of compensation for trustees; it passes upon petitions of parties-in-interest to intervene in the proceedings. It is given broad powers of supervision over protective committees and over solicitation of proxies and deposit agreements in connection with their activities. Its approval is essential before a plan of reorganization can go into effect, and it may initiate plans on its own authority. The Commission is thus in a position where it can assume active sponsorship of interests in reorganization proceedings which in the past have been inadequately represented; it can extend a degree of protection to small investors which they have not hitherto received.

The delay in effectuating reorganizations under Section 77 makes it difficult to evaluate the consequences of this new grant of power with any assurance. With many railroads in a state of continued depression, speedy reorganization on a basis of low earnings would involve drastic sacrifices which creditors and stockholders are naturally reluctant to make. Hope of improvement in earnings is thus a spur to delay. The process provided is complex, and the mechanism offers few compulsions to speed.[43] Meanwhile, the Commission has at least demonstrated its intention to prevent the dissipation of the debtor's estate and to conserve the interest of investors by ruthlessly

[43] In the hope of expediting procedure in railroad reorganization cases, the Senate in 1939 passed a bill providing for the creation of a special Railroad Reorganization Court to be composed of five members with the rank of circuit judges. This court would take over from the district courts the task of handling all Section 77 reorganization cases. Appeals would lie directly to the Supreme Court. The House took no action and the measure died. Further reform of reorganization procedure is thus dependent on the introduction of new legislation at some future session of Congress. Meanwhile, both houses did enact the Chandler Act which permits voluntary railroad reorganization without resort to bankruptcy proceedings. This act was primarily intended to enable the B. & O. and the Lehigh Valley to put into effect certain debt readjustment plans which were subsequently approved by the I.C.C. The life of the Chandler Act was limited to one year.

pruning fees paid to trustees, counsel, and protective committees. Financial control groups are thus subject to checks and restraints which have not been operative in the past.

While investors have been offered a modicum of protection in reorganization proceedings, their interests have suffered in other respects. The rapid development of new and competitive means of transportation continued to make sharp inroads into railroad revenues. The level of revenue and income, even at the height of the New Deal recovery in 1937, was well below the average of the 1921–29 period. Dividend rates and payments as well as the market value of railroad securities registered a marked decline. The percentage of railroads on a mileage basis in the hands of trustees or receivers, which from 1921 to 1932 never exceeded 9 per cent, rose to 27 per cent in 1935 and 31 per cent as of July 31, 1938. Faced with these developments, private investors showed an increasing disposition to boycott the railroad field. The government was forced to step into the breach. Through the Reconstruction Finance Corporation and the Public Works Administration the national government became a substantial investor in railroad securities, with a vital stake in salvaging its investment.

But while the government became involved in the railroad industry in the role of investor, it was also sensitive to the claims of other parties-in-interest. The increased influence of labor was particularly evident from the very beginning of the New Deal. The newfound power of labor offered a formidable obstacle to programs of retrenchment designed to safeguard investors' interests. The Emergency Railroad Transportation Act of 1933 was originally conceived by representatives of investors who sought to improve the economic status of the railroads by encouraging economies in operation, chiefly at the expense of labor. The railroad labor unions succeeded in adding a clause—7B—which ensured that the recommendations of the Federal Co-ordinator of Transportation could not be put into effect when the result would be a reduction in the number of employees or the amount of their compensation below the level prevailing in May, 1933. Railroad labor firmly opposed all co-ordination projects which made no provision for displaced employees.

In order to overcome this opposition, the Federal Co-ordinator suggested a system of dismissal compensation to be administered in connection with co-ordination projects sponsored by him. The Wheeler-Crosser Bill, which was sponsored by labor, was designed to carry out

this recommendation. With the impending expiration of the Emergency Transportation Act on June 16, 1936, carriers would once again have been at liberty to reduce employment without any check. In anticipation of this contingency, the Railway Labor Executives Association approached railroad management in a series of conferences with the object of negotiating a voluntary agreement for the adoption of a system of dismissal compensation. The conferences proved unproductive—with the result that labor mobilized administrative pressure behind the Wheeler-Crosser Bill. On May 21, 1936, an agreement was concluded, but it is worth noting that railroad companies accepted the agreement largely because they feared the enactment of the more drastic Wheeler-Crosser Bill. Administration sympathies helped to tilt the scales in the negotiations and facilitated the acceptance of labor's demands.

Other labor gains were registered in the legislative arena. The Railway Labor Act of June 21, 1934, amending and supplementing the Railway Labor Act of 1926, provided for more explicit recognition of the right of employees to organize and to engage in collective bargaining; it also strengthened and made more effective the machinery for the adjustment of disputes between employers and employees.[44] In the same year, the first Railroad Retirement Act was passed. When the Supreme Court pronounced the Act unconstitutional in 1935,[45] Congress promptly enacted a substitute which sought to meet the Court's objection. After the constitutionality of the Social Security Act was upheld by the Supreme Court a third Railroad Retirement Act was enacted on June 24, 1937, which modified the Act of 1935 in certain particulars. In 1938 a railroad unemployment insurance act was enacted.[46]

Wage adjustments were also favorable to labor. The 10 per cent reductions of 1932 were fully restored to the employees by April 1, 1935. Two agreements increasing wages were made in 1937. The addition to the annual wage bill as a result of these increases was estimated on the basis of 1936 employment to amount to approximately $130,000,000 per year. Following a sharp decline in business activity and intensification of the financial distress of the carriers, railroad management on May 12, 1938, served notice of a proposed

[44] See Chapter 6 for further discussion.

[45] *Railroad Retirement Board* v. *Alton R.R. Co.*, 295 U.S. 330.

[46] For further discussion of railroad social security legislation see Chapter 21.

15 per cent wage cut. Employees refused to accept the cut. Negotiations proved fruitless and the President, invoking the procedure of the Railway Labor Act, appointed an Emergency Board to investigate the controversy. On October 29, 1938, the Board, composed of Judge W. P. Stacy, Dean James M. Landis, and Professor Harry A. Millis, recommended that the proposed wage reductions be cancelled. Management accepted the recommendation. While wage rates have been maintained and improved in the years since 1933, and other gains have been won for employed railroad labor, it is also important to note that railroad employment as a whole has followed the cyclical and secular trend of the industry. Total railroad employment remains far below the level of the twenties. Caught in the vise of a declining industry, labor has exerted every effort to preserve and extend its share of a dwindling income stream.

Shippers and other users of railroad service have resisted efforts to conserve investor and labor interests at their expense, but with less effectiveness. The movement to lower rates had its greatest success in the passenger field. By 1932, when the Interstate Commerce Commission took steps to initiate a change in policy, a large proportion of the railroad executives outside of the East were prepared to experiment with lower rates in the hope of rejuvenating passenger revenues. During the next year carriers in the South and the West instituted marked reductions. The largest roads in the East held back, fearing that they would lose more revenue than they would gain. In spite of this opposition, on February 26, 1936, the Commission entered an order effective June 1, 1936, providing for the abolition of the Pullman surcharge, a maximum fare of 2 cents per mile in coaches and 3 cents in Pullman cars. The order was to be effective, not only for Eastern trunk line territory, but for the United States as a whole. The fears of the Eastern carriers were not realized; passenger revenues improved, but railroad management was not sure how much of the improvement was due to the stimulating influence of lower fares and how much to a cyclical upturn. With the sharp downward trend of business in the second half of 1937, the Eastern carriers, hoping to recoup losses, pressed for an increase in the basic coach fare to 2½ cents. The Commission on July 5, 1938, consented,[47] out of deference to management, though with considerable misgivings as to the beneficial effect which such increases might have on carrier revenues.

[47] *Ex Parte No. 123,* 227 I.C.C. 685.

Subsequent experience confirmed these misgivings, and a new experiment with lower rates was launched early in 1940.[48]

During the same period shippers of freight were less successful in their struggle for a general lowering of the level of railroad rates. On January 25, 1933, at the depth of the depression, a number of national associations, representing farm products and basic commodities, filed a petition with the Interstate Commerce Commission, requesting an investigation of the reasonableness of freight rates on all basic commodities. The Commission widened the inquiry to embrace all existing interstate freight rates and charges. After giving consideration to the claims of shippers, it decided on July 31, 1933, that the revenue needs of the carriers were so pressing as not to permit a general reduction in rates. The new rate-making formula introduced by the Emergency Railroad Transportation Act of 1933 instructed the Commission, in exercising its power to prescribe just and reasonable rates, to give due consideration, among other factors, "to the effect of rates on the movement of traffic; to the need, in the public interest, of adequate and efficient railway transportation service; and to the need of revenues sufficient to enable the carriers, under honest, economical, and efficient management, to provide such service." In construing this rule, the Commission gave the revenue needs of the carriers controlling weight.[49] The decision evoked sharp dissent from within the Commission. Commissioners Aitchison, Porter, and Lee were of the opinion "that the great bulk of freight rates which had not been reduced by competitive pressure were on an unreasonably high level."

The Commission responded to this criticism in part by discontinuing from October 1, 1933, the emergency increases which had been put into effect as a result of the *Fifteen Per Cent* case of 1931.[50] But the financial needs of the carriers continued to be acute and in 1935 the railroads pressed for authority to increase their freight rates to yield approximately $170,000,000 per year in additional revenue. The Commission denied this request, but it did authorize specified emergency increases, not unlike those approved in the *Fifteen Per*

[48] The basic coach rate of 2 cents a mile was re-established, and Eastern carriers announced a reduction in round-trip coach fares for distances of over 100 miles to a basis as low as 1.5 cents a mile. Reductions are computed on a sliding-scale basis. Reductions were also announced in round-trip, upper-berth Pullman fares.

[49] *General Rate Level Investigation,* 195 I.C.C. 5 (1933).

[50] 178 I.C.C. 539.

Cent case.[51] These increases remained in effect until December 31, 1936, when they were allowed to expire because of improved business and rising traffic conditions.

Even before the expiration of the emergency increases, the carriers filed another petition on October 23, 1936, for a general increase in commodity rates which was calculated to yield from $85,000,000 to $90,000,000 a year, or about 70 per cent of the estimated yield of the emergency increases. In 1937 the carriers were given the opportunity to make these increases effective in large part.[52] The freight rate increases granted were estimated to yield more than $69,000,000 a year; in addition, increases in passenger rates to amount to $15,000,000 were authorized in the West and the South.

These increases had hardly been announced when the carriers came forward with a new proposal for a blanket increase of 15 per cent in all freight charges. The 1937 revision had been predicated on the assumption that the revival of business would continue for some time. Meanwhile, the railroads had found it necessary to agree to a wage increase of $130,000,000 annually; they found themselves faced with increased taxes and a strong increase in the prices of their supplies, "and as a climax to these discouraging changes in conditions, the bottom fell out of their traffic. A severe decline in October became precipitous in November and December." The increases demanded were designed to cover mounting expenses which the carriers had not anticipated and which amounted "to perhaps as much as $248,000,000 annually."[53] These considerations were presented to the Commission by the carriers as a justification for the proposed increase. A wide variety of shipper groups appeared in opposition. A great majority took the position "that the proposed increases would do the rail carriers no good, in that the effect . . . would simply dry up rail traffic by causing diversion thereof to competing forms of transport agencies, or a relocation of industry or change of the manner of distribution."[54]

In the light of the evidence submitted, the Commission decided against a 15 per cent increase, but it did authorize a general 10 per cent increase in freight rates from which certain groups of commodities, products of agriculture, forests, and mines, were either

[51] *Emergency Freight Charges Case*, 208 I.C.C. 4 (1935).
[52] *General Commodity Rate Increases*, 223 I.C.C. 657 (1937).
[53] *Fifteen Per Cent Case*, 1937–38. *Ex parte No. 123*, 226 I.C.C. 41 (1938), at p. 152.
[54] *Ibid.*, p. 75.

partly or wholly excepted. The Commission's decision was designed to spare distressed industries. Its effect in other areas was problematical. "At best," pointed out Commissioner Eastman, "it is only a palliative, and whether it is even that remains to be seen."[55] In seeking to shift the burden of business decline onto shippers, the railroads may only be hastening the diversion of traffic to competing transportation agencies.

The rate history of the period since 1933 reveals the strains generated by the pressures of rival groups seeking maximum advantages from a declining industry. A shrinking but potent labor force operating in a favorable political milieu gains advantages in the form of wage increases and provisions for security. Management acting on behalf of investors attempts to shift the burden of increased expenses to shippers. The Interstate Commerce Commission seeking to mediate between investors and shippers pursues a temporizing policy. The revenue needs of the carriers make some rate increases imperative; the dangerous ultimate effects on carrier revenues involved in attempting to cast the whole burden of carrying the industry on consumers lead to denials of the full range of rate rises demanded by the railroads. Some shippers faced with rate increases find avenues of escape in relocating their plants or in other modes of transportation. Others, whose traffic is more closely tied to the rails, complain that the high railroad rates imposed on them have discriminatory effects which harm their development.

Given this setting, the regulatory activity of the Interstate Commerce Commission necessarily generated much dissatisfaction. In a period of dynamic industry expansion, the regulatory agency charged with adjusting the relationships among the parties-in-interest in that industry finds its task considerably lightened by expanding vistas of corporate well-being. The task of regulating an industry in a period of distress and contraction is far more challenging. Parties-in-interest do not contend for the privilege of making the first sacrifice. The regulatory agency is powerless to satisfy the expectations which have been aroused in a more hopeful era. Regulatory principles fashioned to deal with phenomena of expansion reveal themselves as inadequate when contraction comes. Thus, the Interstate Commerce Commission can neither guarantee the carriers the revenues which they demand nor give the shipper the relief which he asks. The Commission may adjust railroad rates, but it has little or

[55] *Ibid.*, p. 155.

no control over railroad expenses; and it is only beginning to exercise some effective control over the competition offered by rival modes of transportation. Labor costs are outside its jurisdiction. Its power to compel capital readjustments and scaling down of fixed charges is limited and subject to court review. It may exercise its persuasive gifts to advance railroad rationalization, but mandatory authority in this sphere is lacking. The sanctions necessary to function effectively in a period of decline have thus been denied to the Commission.

Nor are the existing organization and habits of work of the Commission particularly well suited to the task of anticipating and preventing the maladjustments of a transition period. As Commissioner Eastman has pointed out:

> Anyone who has served on the Commission knows that it is not well adapted to such work. Its functions are performed under quasi-judicial procedure. Its attention is occupied with specific causes which must be decided. It has little time for thought and research on broad lines. It is difficult for commissioners to confer with parties on controversial issues, without constant need of protecting their own position in the event that they are called upon to play the part of judges in actual litigation. Planning and prevention are not matters which can well be handled at off times or as side issues. They require single-minded, concentrated attention.[56]

These deficiencies of the regulatory instrument, combined with a general reluctance among parties-in-interest to recognize the changed economic setting and a wishful hopefulness that time will bring its own solution, have served to impede affirmative action in grappling with the problem of framing a constructive national transportation policy.

9. The Problem of Transportation Co-ordination

The appointment of Eastman as Federal Co-ordinator of Transportation in 1933 involved the first serious effort to address public attention to the problem of revising national transportation policy. Unfortunately, the office was created as a temporary expedient. The Emergency Transportation Act of 1933 limited its life to one year, but gave the President power to renew the office for a second year. In 1935 Congress provided for another year's extension. On June 16, 1936, the office went out of existence when Congress failed to act on Eastman's recommendation for a further extension. Eastman fell

[56] *Report of the Federal Co-ordinator of Transportation, 1935* (1936), pp. 41–42.

victim to pressure politics. Some of the proposals which he had sponsored had aroused opposition from both railroad labor and railroad executives; in the face of this opposition, Congress was content to allow the office to lapse.

The experience of the Federal Co-ordinator deserves to be carefully analyzed both for its failures and for its successes. Broadly speaking, the work of the Co-ordinator fell into two general categories: (1) the field of operating and management economies; and (2) study and preparation of plans for the improvement of transportation public policy. In the first field, Eastman had few successes to report, although important and valuable studies were published. In the second field, the Co-ordinator had much to do with laying the groundwork for the enactment of the Motor Carrier Act of 1935 and the Transportation Act of 1940, although his proposal for the concentration in the Interstate Commerce Commission of all regulatory activities in connection with transportation was not enacted in complete form.

The difficulties encountered by the Federal Co-ordinator's "operating economy" program furnish a vivid illustration of the obstacles which face any program for thoroughgoing rationalization of railroad operations. The Act of 1933, to be sure, was temporary in nature, and it did not arm the Co-ordinator with very much power. The Co-ordinator was instructed to undertake investigations with a view to promoting economies and avoiding unnecessary waste and preventable expense. He was to submit his recommendations for action to three regional co-ordinating committees, composed of railroad officials. If the committee failed to act, the Co-ordinator was authorized to issue orders which, on appeal, were subject to review by the Interstate Commerce Commission.

The Co-ordinator's staff proceeded to undertake a number of comprehensive studies bearing on practically every aspect of railroad organization, operation, and maintenance. An imposing list of co-ordination prospects was surveyed. The Co-ordinator made recommendations. But, with few exceptions, nothing came of these recommendations. Vested interests in the *status quo* offered effective resistance. Section 7(b), which had been inserted into the Act of 1933 at the behest of labor, served to defer economies at the expense of labor. Carriers possessing strategic advantages were reluctant to share them with other carriers. The Co-ordinator noted that railroad management was "intensely individualistic and suspicious of collective action . . . plans for . . . co-ordination in railroad affairs meet re-

sistance because they are foreign to certain habits of thought which are the growth of many years." [57] Other influences were also antagonistic to co-operation and co-ordination.

> Labor [pointed out Eastman] is hostile, fearing loss of employment, and there are railroad officers, both major and minor, who have similar fears. . . . Various supply companies are not friendly to collective railroad action in such matters as scientific research and purchases. Various large shippers are accustomed to play one railroad against another to their own advantage and do not like to see such opportunities reduced. Shippers are particularly antagonistic to increases in the charges for accessorial services.[58]

All these interests converged to oppose co-ordination projects.

The Co-ordinator did have the power to issue orders; yet, with one minor exception, no orders were issued. The Co-ordinator explained that he first preferred to exhaust the possibilities of voluntary co-operation in view of the difficulties which would be encountered in putting any plan into effect which did not enjoy the support of those who were to administer it. On February 1, 1936, however, the Co-ordinator announced that he planned to issue an order requiring the co-ordination of railroad terminal facilities at eleven specified points. The order itself was never issued. In response to protests from labor, the President requested the Co-ordinator to hold up the order until provisions had been made for dismissal compensation to protect the interests of labor. The agreement between labor and management was not reached until May 21, 1936. On June 16, the Co-ordinator's term expired and, in view of the opposition of both railroad labor and management, Congress refused to extend the life of the organization. Further development of co-ordination projects thus depends upon voluntary agreements of interested carriers. The political context in which railroad rationalization was involved made the Federal Co-ordinator "a prober of possibilities" rather than "a doer of deeds."

The Federal Co-ordinator enjoyed greater success in the planning of transportation policy. In a series of very able reports, the whole transportation situation was canvassed and various alternatives in public policy were explored. Three possibilities were envisaged: (1) public ownership and operation; (2) a plan for the compulsory

[57] *Ibid.*, p. 37.
[58] *Ibid.*

consolidation of railroads into a few systems, with possible minority participation in management by the federal government; and (3) a plan for the extension and improvement of the present system of federal regulation of privately owned and operated carriers. The first and second plans were rejected. "Theoretically and logically public ownership and operation meets the known ills of the present situation better than any other remedy," Eastman pointed out. "Many of the dangers which are ordinarily seen in public ownership and operation," he also asserted, "can be brought under control if suitable precautions are taken." Nevertheless, he argued that the plan would involve serious financial dangers to the country under present conditions and it seemed to him "at least questionable whether the railroads alone could well be nationalized without including other forms of transport to some considerable extent." [59]

The second plan was also rejected

> not only because the present uneven distribution of competition would be accentuated, with enhanced danger that population and business would tend to concentrate at favored points, a most serious danger from the standpoint of proper development of the country, but also for the practical reason that a consolidation of this character . . . would precipitate a controversy in which many railroads, many communities, and labor would join with equal vigor and from which it would be difficult to emerge.[60]

In advocating the third plan the conclusion was reached that the major transportation agencies should be subjected to co-ordinated federal regulation by a single agency, the Interstate Commerce Commission, that the Commission should be reorganized in order to perform its new duties more effectively, and that a permanent Co-ordinator of Transportation, selected from the membership of the Commission and associated with it, should continue to perform functions similar to those exercised by the Co-ordinator under the Emergency Transportation Act of 1933. Two important bills, one providing for motor carrier regulation and the other for the regulation of water carriers by the Interstate Commerce Commission, were drafted and recommended for Congressional action. The Co-ordinator's motor

[59] See *Report of the Federal Co-ordinator of Transportation, 1934* (1935), H.Doc. 89, 74th Cong., 1st Sess., p. 2.

[60] *Ibid.*

carrier recommendations, in amended form, were enacted in 1935 and represented a powerful extension of the jurisdiction of the Interstate Commerce Commission.[61] Consideration of the water carrier bill was postponed. Instead, Congress, in enacting the Merchant Marine Act of 1936, created a new agency—the United States Maritime Commission—to which was transferred the regulatory jurisdiction over water carriers which had previously been exercised by the Shipping Board Bureau of the Department of Commerce.[62] Subsequently, Congress on June 23, 1938, created another independent agency, the Civil Aeronautics Authority, and endowed it with regulatory jurisdiction over air carriers.[63] In sacrificing the logic of unifi-

[61] The Motor Carrier Act of 1935 separates motor carriers into four classes: (1) common carriers who hold themselves ready to serve anyone; (2) contract carriers who confine their operations to serving shippers whom they have agreed to serve; (3) private carriers who serve only themselves; and (4) brokers who arrange for the sale of transportation services. Common carriers are required to make a showing of public convenience and necessity in order to receive a certificate authorizing operations. Contract carriers are required to show personal fitness, ability to perform the service, and that the proposed operation will be consistent with the public interest before being granted a permit to operate. Private carriers are required only to comply with safety regulations and requirements as to qualifications and maximum hours of service of employees. Brokers must be licensed and are forbidden to use other than authorized carriers in the performance of their functions.

Common carriers are subject to a regulatory regime very similar to that applicable to railroads. Rates, security issues, mergers and consolidations, accounting practices, service and safety standards are all subject to regulation. The requirements as to contract carriers are somewhat less comprehensive. In the case of contract carriers the I.C.C. regulates only minimum rates. Administration of the Motor Carrier Act is vested in a Bureau of Motor Carriers in the I.C.C., and provision is made for the adjustment of potential conflicts between federal and state authority through the operation of joint boards.

[62] See Chapter 4 for further discussion.

[63] For discussion of the background of public aid to air carriers see Chapter 4. The Civil Aeronautics Act of 1938 created an Administrator to operate air navigation facilities and carry on general promotional and development activities, an independent Air Safety Board to investigate accidents, and a five-man Authority to exercise quasi-legislative and quasi-judicial powers in the field of economic and safety regulation. By the provisions of Reorganization Plans III and IV, which became effective in 1940, the Air Safety Board was abolished, the office of Administrator of Civil Aeronautics was transferred to the Department of Commerce, and the five-man Authority became the Civil Aeronautics Board. While the Board was placed within the framework of the Department of Commerce for the performance of routine housekeeping functions, the Board retained its independent status in carrying on its activities in the fields of safety and economic regulation.

cation of regulatory authority in the transportation field, Congress was apparently influenced by the fear that combining air carriers with railroads and motor carriers under the same regulatory agency might hamper the development of aviation. Air carriers still play a minor role in the total transportation scene, but as they increase in importance, the problem of adjusting the relations among rival transportation agencies may make unified treatment imperative.

10. The Transportation Act of 1940

On March 17, 1938, President Roosevelt appointed a committee composed of three I.C.C. commissioners—W. M. W. Splawn, chairman, and Commissioners Eastman and Mahaffie—to make recommendations for the improvement of existing conditions in the railroad industry. This report, together with brief comments by the President and other high government officials, was submitted to Congress for consideration on April 11, 1938.[64]

The recommendations of the Splawn Committee were divided into two parts: (1) means of immediate relief and (2) a long-term program.

With respect to immediate relief the Splawn Committee made a number of proposals. (a) It recommended that facilities be provided for the purchase of railroad equipment through the use of government funds. It suggested that $300,000,000 be made available for this purpose, the government to lend this money to the railroads and the equipment to be security for the advance.

(b) It recommended that for a twelve-month period the R.F.C. be permitted to make certain loans to the railroads without I.C.C. certification that the applicant railroad "may reasonably be expected to meet its fixed charges without reduction thereof through judicial reorganization." If adopted, this would have represented a considerable change in policy; it was apparently inspired by the fear of further railroad bankruptcy and the dangerous impact of such defaults on general credit conditions.

(c) The Committee also considered the possibility of the use of government credit: 1. to pay a subsidy to railroads to help them meet their fixed charges and 2. to use government credit to underwrite or guarantee bonds issued in the reorganization of railroad capital

[64] H.Doc. 583, 75th Cong., 3d Sess., 1938.

structures, with the object of reducing the burden of fixed charges. Of these two possibilities, the Committee believed the second more worthy of consideration.

(d) The Committee recommended that existing railroad statutes be amended to repeal the government's 50 per cent discount for transportation over land grant railroads. The enactment of this measure meant a saving to railroads of about $7,000,000 a year and was of particular interest to railroads in the West.

(e) The Splawn Committee pointed out that a reduction, or at least a temporary reduction, in railroad wages and salaries would be a means of very definite and positive relief to the carriers, but the Committee itself refused to express an opinion either in favor of or against such a reduction.

(f) The Committee recommended certain improvements in reorganization procedure under Section 77 of the Bankruptcy Act. It suggested the establishment of a single railroad reorganization court to replace the existing division of authority between the I.C.C. and the federal courts.

The Committee's long-term program stressed two main lines of attack:

(a) It recommended that a body of three members, to be known as the Federal Transportation Authority, be established for a period of two years—with Presidential power to extend the life of the Authority for a five-year period. This Authority would be vested with the function of planning and promoting action by the railroad companies to eliminate waste and duplication of services. Roughly, the duties of the Authority would be like those of the old Federal Co-ordinator of Transportation with the important difference that the Authority would not be given power to issue orders, a power which the old Co-ordinator possessed. All orders would be issued by the I.C.C. The I.C.C. would be given power to require co-ordinations (which the Committee defined as co-operation in a common interest at particular places or with respect to particular matters such as pooling of traffic or unified terminal operations), but no authority would be vested in the I.C.C. to compel consolidation. The Authority would be primarily an investigatory body. It would be directed among other things to investigate the relative economy of various forms of transportation, to determine the appropriate sphere of each, and to eliminate wasteful and destructive competition between them. Actual powers would remain with the I.C.C., as at present.

(b) The Committee also recommended subjecting all forms of transportation to equal and impartial regulation by a single agency of the government—presumably the I.C.C.

President Roosevelt, in submitting the report of the Splawn Committee to Congress, made only brief comments. He expressed himself as opposed to government subsidies in order to enable the railroads to meet their fixed charges, and he also declared himself opposed to government ownership and operation. He pointed out that matters relating to transportation were being dealt with by seven different government agencies. From the point of view of business efficiency, he argued the desirability of concentrating all executive functions relating to transportation in one single department. He did not mention a special department of transportation, but he apparently envisaged that as one possibility. At the same time, he recommended that all quasi-judicial and quasi-legislative matters relating to transportation be placed under an independent commission—preferably the I.C.C.

These recommendations came late in the session and, with Congress anxious to go home for the primaries, no legislative action was taken. Meanwhile, the demand for new transportation legislation continued, and on September 20, 1938, the President appointed a joint committee of six—three representatives of railroad management and three representatives of railroad labor—to submit recommendations upon the general transportation situation. This committee reported December 23, 1938.[65] Among its most important proposals were the following:

(1) Legislation which would provide uniform regulation, similar in character and scope for all modes of transportation—rail, highway, pipe line, air, and water (coastal, intercoastal, inland, and the Great Lakes). The I.C.C. would exercise this jurisdiction.

(2) A revision of the rate-making rule—which would emphasize the necessity of making adequate provision for the revenue needs of the carriers.

(3) Repeal of the long and short haul clause.

(4) Establishment of a new independent agency—to be known as the Transportation Board. This agency would be charged with the duty of investigating and reporting to Congress with regard to the relative economy and fitness of the several modes of transportation

[65] *Report of President's Committee to Submit Recommendations upon General Transportation Situation* (1938).

and the extent to which any of them is now being subsidized, with recommendations for further legislation. This agency would also administer regulatory provisions covering certificates of convenience and necessity, the issuance of securities, consolidations, mergers, leases, acquisitions of control, and interlocking directorates. It would also assume responsibility for all functions of a research or promotional nature relating to any mode of transportation now vested in other agencies.

(5) A system of tolls for commercial use of certain inland waters, and discontinuance of the operation of the Federal Barge Lines by the Inland Waterways Corporation. This recommendation was designed to reduce or eliminate water carrier competition with the railroads.

(6) Legislation relieving railroads of certain tax burdens and providing that government bear the expense of eliminating grade crossings.

(7) Legislation to reimburse railroads, required to reconstruct bridges or other facilities in connection with river improvement programs, for all costs incurred by the railroads in excess of any direct benefit accruing to them.

(8) Repeal of the deductions in freight rates enjoyed by the federal government on land grant railroads.

(9) Creation of a Railroad Reorganization Court which would relieve the I.C.C. of all responsibility in railroad reorganizations.

(10) Repeal of the consolidation plan provisions of the Transportation Act; instead, the approval of the Transportation Board would be required in connection with any proposed consolidation, such approval not to be granted unless provisions were made to protect the interests of employees affected.

(11) An enlargement of the powers of the Reconstruction Finance Corporation to permit purchase and guarantee of railroad obligations, and curtailment of the power of the I.C.C. to disapprove loans.

These recommendations reflect their source. The primary preoccupation of the Joint Committee of Six was with the needs of the railroads, and their primary objective was to improve the competitive position of the railroads in the transportation arena.

With the recommendations of the Joint Committee of Six and the earlier Splawn Committee before it, Congress in 1939 turned seriously to the task of writing new transportation legislation. After prolonged hearings and considerable delay while differences between the Senate

and House bills were being ironed out in conference, the Transportation Act of 1940 was finally enacted.

The most important provision of the Transportation Act of 1940 is the expansion of the power of the I.C.C. to include regulation of rates and services of common and contract water carriers [66] in domestic commerce and authority to fix minimum as well as maximum joint rail-water rates. Appropriate exemptions are made for bulk carriers on the Great Lakes and other contract carriers noncompetitive with common carriers.

In addition, the Act contains a number of other provisions of lesser importance which are designed to help the railroads. Among these are (1) a provision repealing the government 50 per cent discount for transportation over land grant roads; henceforth the government will pay full rates on all of its shipments; (2) liberalization of the lending powers of the R.F.C. in the railroad field; and (3) elimination of existing statutory requirements that the railroads, in effecting mergers, shall follow an "official" plan prescribed by the Commission. Railroads are given greater freedom to pursue their own plans subject to I.C.C. approval; the I.C.C., however, may impose requirements to protect the interests of employees affected by proposed consolidations; (4) provision is made for the shortening of time limits during which reparation and undercharge claims can be made by shippers against the railroads.

In addition, certain concessions are made to the farmers. The I.C.C. is instructed to grant reduced export rates on all farm, livestock, and horticultural products. At the present time the Commission provides somewhat lower rates for industrial products destined for export as compared with domestic rates on the same products. This provision of the Act requires that farm products destined for export be granted the same relative advantage. There is also a provision directing the Commission to investigate interregional freight rates and to correct unreasonable differentials. This provision was included to meet Southern and Western complaints of freight rate discrimination against those areas.

Finally, the Act provides that the President appoint an independent three-man board to investigate the relative economy and fitness of rail, water, and motor carrier transportation with a view to determining which services should be encouraged or discouraged in the interest of avoiding wasteful and destructive competition. The

[66] For distinction between common and contract carriers see footnote 61, p. 289.

Board is likewise to inquire into the extent of government subsidies enjoyed by the respective types of transportation and to submit a report with recommendations to Congress.

With the enactment of this legislation, the national government for the first time enjoys comprehensive power to regulate all modes of transportation. But the establishment of one or more regulatory agencies endowed with comprehensive jurisdiction over all modes of transportation will not serve as an automatic dissolvent of carrier rivalries. The pressure for favorable concessions, it is safe to say, will continue to converge on regulatory authorities and remain an inextricable part of the process of regulation. A regulatory agency engaged in promoting a national system of transportation is necessarily involved in balancing the claims of the various branches of the transportation industry for preferential treatment. The agency may conceivably pursue a policy of favoritism; objections to concentrating regulation of all branches of transportation in the Interstate Commerce Commission frequently take as a point of departure the thesis that that agency is "railroad-minded." The advantage of unification of control is not that it disposes of this danger, or that it obliterates rivalries, but that it makes possible a more comprehensive view of the transportation problem as a whole. As Commissioner Eastman has said, "If transportation is to be co-ordinated, regulation must be co-ordinated. . . ." [67] Such co-ordination may bring into play a broader conception of public interest and public needs.

The object of such control [the Co-ordinator has pointed out] is not the protection of the railroads only but the proper protection of every form of transportation. They all have their parts to play, for each of them can do certain things better than any other agency. The problem is to find their appropriate functions, protect them in the performance of such functions, prevent wasteful duplication of service without eliminating such competition as is economically sound, and promote a system of stable rates which will reflect the lowest costs of good service but afford the necessary foundation for credit. It is too much to expect that all of the present facilities of transportation in each group can survive, for there are many which are now without economic justification, but out of the present confusion and waste a sound and well-co-ordinated national system of transportation can be built.[68]

[67] Federal Co-ordinator of Transportation, *Regulation of Transportation Agencies* (1934), S.Doc. 152, 73d Cong., 2nd Sess., pp. 96–97.

[68] *Ibid.*, p. 96.

The task of weaving a pattern of control which will achieve these purposes is admittedly difficult. Its successful accomplishment implies the existence of flexible regulatory instruments, equipped with adequate authority, enjoying widespread public support, and capable of exercising intelligent foresight in shaping transportation developments to meet national needs. Whether such instruments can be created and whether they can develop sufficient manipulative power to make the public interest in a co-ordinated system of adequate transportation service paramount over the special interests which may have to be sacrificed in attaining such a system is at least dubious. The experience of the Federal Co-ordinator is not vastly encouraging, although it marks a significant first attempt. It makes clear, at least, that a comprehensive transportation policy which cannot find satisfactory terms of adjustment with the significant parties-in-interest concerned in its operation is probably doomed to frustration.

The history of the growth of railroad regulation in the United States has been essentially a tale of a series of pragmatic adjustments to circumstance. The traditional *modus operandi* has been one of dealing with evils and their effects after they have occurred; rarely has public policy sought to anticipate and forestall them. Consequently, regulators are almost always confronted with *faits accomplis* in the form of industry situations which have taken shape and crystallized before regulation appears on the scene. Such situations necessarily limit the freedom with which the regulator can act. Clusters of interests have grown up; expectations have been aroused; innocent parties have become involved; relationships have been established which the process of regulation must take into account.

The railroad industry today presents these complications in a particularly acute form. Technical changes have brought other forms of transportation into being and imperiled the financial stability of the industry. The bitter struggle for traffic has been intensified by prolonged depression. The parties-in-interest whose fortune and future are intimately dependent upon the fate of the railroad industry face shrinking rather than expanding vistas. The natural tendency is to seek to shift the burden of necessary readjustment to such parties-in-interest as demonstrate weakness either in private bargaining or in the political arena, and to make public policy itself the vehicle for transferring the costs of technical and economic changes to the general public. The formulation of a national transportation policy will therefore be influenced by the expediencies which these conditions

generate. How far it can rise above them will depend, in the final analysis, upon whether a political and economic environment can be developed in which the common interest in an adequate transportation system becomes more articulate and influential than the immediate desires of the special interests concerned for preferential treatment.

Chapter Ten. ELECTRICAL UTILITIES

The regulation of electrical utilities presents a case study in the regulatory process offering interesting contrasts with railroad regulation. As far as the legal basis of regulation is concerned, electrical utilities and railroads both fall into the same general category. Both are recognized as public utilities and are, therefore, legally subject to regulation of rates and services. But there the resemblance begins to fade. The railroad industry is a relatively old industry, which already shows signs of decline and enfeeblement in its struggle with competing modes of transportation. Though its owners and management fought regulation vigorously at one time, they have grown to accept regulation as part of the normal pattern of their existence. With electricity, the institutional setting is very different. Electricity is a relatively new industry. It is still expanding. The trend of power output is strongly upwards. Regulatory action in this field is still a relatively recent phenomenon. The leaders of the industry have been, for the most part, vigorously opposed to regulation and are aggressive in resisting its extension. Regulatory agencies in this area, therefore, faced industry attitudes very different from those encountered in the railroad field.

1. The Electric Power Industry

The electrical industry is young. Though the first Edison station was opened nearly sixty years ago, the real development of the industry is a twentieth-century phenomenon. Between 1902 and 1936 installed capacity increased about eighteenfold and the amount generated nearly twenty-fourfold. Nor did the Great Depression beginning in

1929 seriously interrupt the expansionist trend of the industry. By 1935 the peak consumption of 1929 was surpassed, and the secular trend has continued upward.

This period of growth, moreover, has been marked by striking technological innovations which have made cheap power feasible. These technological advances have encompassed the whole gamut of the industry—generation, transmission, distribution, and utilization. These improvements within the industry have laid the basis for what has come to be called "the power age." Already electric power has attained a paramount and indispensable position both in industry and in the domestic economy. Yet the fact remains that, with all the splendid technical achievements of the industry, its potential benefits have been by no means fully realized. This has been particularly true in the field of residential and rural consumption. Lighting and minor appliances still account for the bulk of residential consumption. Though major appliances such as refrigerators and washing machines are coming into wider use, more than three quarters of all American families are still without electric refrigerators and more than two thirds without electrical washing machines. The use of electricity for cooking, heating, and air conditioning remains largely unexploited. The high cost of appliances, restrictive rate schedules, consumer inertia, and lack of purchasing power all combine to limit domestic utilization of electricity. The potentialities of rural electrification continue unrealized in large measure. Service is still confined to well-to-do and more thickly settled areas and rarely extends beyond lighting and other minor household purposes. The electrification of farm operations, except in poultry and dairy farming, is still largely an unfulfilled dream. This ripe field for development is only beginning to be tapped.

Nor are the prospects for increased utilization limited to residential and rural purposes. In commercial buildings air conditioning has already made a substantial beginning, and the demand is likely to increase. Railroad electrification will probably also provide an expanding market for the future. With further highway expansion, the demand for proper illumination is also likely to increase. About one-fifth of the motive power in manufacturing plants is still unelectrified. The future industrial demand for power is, of course, in large part dependent on the prospects for industrial and business expansion generally. While there is no way of knowing what these prospects are, significant technical advances in the mechanization of production

processes continue to be made, and increased reliance on electric-driven automatic machinery is highly probable.

This brief survey may at least serve to underline the vast technical possibilities for further expansion and development of the electric power industry. Whether these possibilities are realized depends on a variety of considerations—among them, the organization and policies of the industry which supplies power, the trend of economic developments in so far as they affect the demand for power, and the evolution of public policy as a factor affecting both the supply of and the demand for power.

In considering the organization and policies of the electric power industry, the first salient fact worth stressing is the overwhelming predominance of private ownership in the industry. Approximately 90 per cent of all electricity distributed comes from private companies; a little more than 10 per cent is furnished by publicly owned plants.

A second salient fact is the predominance of large systems in the privately owned sector of the industry and the high degree of concentration of control among these systems. A recent study (1935) by the Federal Power Commission revealed that 90 per cent of the private electrical business of the country was conducted by fifty-seven systems. Of these fifty-seven, the twenty-two largest, according to that study, furnished approximately 75 per cent of the total electrical service of the country, and the twelve largest approximately 50 per cent of the country's total service. Many of these systems, moreover, were subject to further over-all integration and control through investment and financial corporations, banking affiliations, intersystem holdings, and other financial connections.

The emergence of this high degree of concentration and control in the industry represented the result of a process of consolidation which started at the beginning of the century, made some headway before the first World War, and proceeded at a feverishly accelerated pace during the twenties as machinery for mass distribution of securities was perfected. Originally electrical companies were local affairs. With advances in technology, it became evident that larger areas could be served more economically and efficiently in the same operating organization. This provided an incentive to consolidation. Enterprising individuals were quick to sense the advantages and to capitalize them. Promoters and banking groups were eager to advance the process for the sake of the possible financial profits involved. Thus, consolidation moved forward by successive stages. At first two or more local prop-

erties were brought together. Later other properties were acquired. Purchases were frequently haphazard and uncontrolled. There was little evidence of any public interest in the result or of the exertion of public authority to direct the process toward public ends. The motivation was private profit, and the dynamic urge upon which many utility empires were built was supplied by the rivalries of banking groups.

The results became evident in the internal organization of the great utility systems. A few confined their operations to a single densely populated metropolitan area and contiguous territory. A second and larger group operated in a sizable but contiguous area in a particular part of the country. A third group operated in noncontiguous territory, but with one or more well-defined main areas of operation. A fourth group consisted of a large miscellany of scattered noncontiguous properties in many different parts of the country. The results were also evident in the corporate structures of the great systems. A few, very few, had relatively simple corporate structures with scarcely any operating subsidiaries. Others had highly complex structures with tier on tier of operating and holding companies and affiliated subsidiaries. Ultimate control was exercised by a financial group which usually had a relatively small financial stake in the underlying physical properties of the empire which it dominated.

For the most part, the organization of the electric power industry subordinated management to the financial control groups. As utility empires were built up, promoters and financiers were frequently compelled to pay excessive prices to acquire possession of property. Write-ups in book assets concealed inflated purchase prices. Securities based on capitalized expectancies that were wildly overoptimistic were unloaded on unsuspecting investors. Meanwhile, the burden of supporting these expectancies fell on the consumer. Financial groups profited through security transactions and manipulations, but this was by no means the only source of profit. Operating companies could be saddled with high salaries and elaborate organizations. Through contracts entered into between holding companies and the operating companies which they controlled, control groups could extract inflated fees for financial services, for construction and development work, and for management advice. Operating companies could be "milked" through upstream loans arranged on terms advantageous to the holding company groups. Devices such as these opened up avenues of profit to the financial control groups which reflected them-

selves, first, in the operating expenses and excessive overhead of the operating companies and, ultimately, in the rates extracted from the consumer. In so far as rates were subject to public regulation, the control groups were necessarily vitally interested in exerting pressure on regulatory agencies to provide rate schedules that would safeguard the financial structures which they had erected, as well as swell the stream of income from which their own wealth and power were derived.

But the success of control groups in exploiting the profit potentialities of the electrical industry depended not only on the tolerance of regulatory agencies, but also on the market for electric power. And this market revealed, and continues to reveal, great variability among different companies and in different sections of the country. In some cases, industrial and commercial demand bulks large; in others, residential or rural consumption is more important. Electric companies, in shaping their rate policies, must necessarily take account of the peculiarities of market behavior. Electricity, contrary to the common assumption, is not always sold under conditions of monopoly. If company rates are too high, the large industrial or commercial user of power may install his own generating plant. In order to attract industrial and other large power users, electric companies must therefore be prepared to supply electricity at rates equal to or less than it would cost these users to provide their own power.

This competitive factor is not entirely absent in other classes of service. Gas may be used for cooking instead of electricity; refrigerators may be foregone in favor of old-fashioned iceboxes. For many purposes, however, residential and small commercial consumers are so vitally tied to electricity that no practical alternative is available. If rates are high, this group may respond by attempting to restrict its consumption in so far as it can. But, in most cases, there remains an irreducible minimum which users cannot forego. In the determination of the price of this minimum they have no effective bargaining power. They are ultimately dependent on the marketing policies which utility management and control groups decide to follow.

The latter groups have a choice. They may seek their profits through a farsighted policy of promoting maximum utilization at low rates. Or, relying on their monopoly position to guarantee them whatever increase in business develops, they may prefer to concentrate their efforts on maximum immediate profits through high rates even though utilization be low. Faced at times with cyclical decline

in the demand for industrial power, they may attempt to recoup their losses in this sector of the market by raising residential and commercial rates. Where the latter policy is pursued, residential consumers and small commercial enterprises bear the full brunt of the utility drive for profit. Dissatisfaction among these groups is apt to mount under such circumstances, and the demand for redress through governmental action is likely to express itself. Public policy then becomes of crucial significance in determining whether utility control groups can pursue their objectives without let or hindrance or whether they will be compelled to adjust their policies to the claims and demands of other parties-in-interest in the electrical utility industry.

An analysis of the various parties-in-interest in the industry is vital to an understanding of the regulatory process as it operates in this area. The importance of the financial control groups has already been stressed. It is perhaps sufficient at this point merely to underline the enormous concentration of economic power which they represent and the potential political power which this signifies. Closely tied up with these control groups, and frequently identical with them, are the financial interests, the banks and investing institutions which mobilize capital, supply funds, and provide financial services for the industry. In fundamental outlook these groups see eye to eye with the utility control groups, as do also, for the most part, the allied industries which draw their sustenance from the electrical utility industry.

Another important party-in-interest is management—the executives, administrators, and supervising and technical personnel of the industry. These individuals are closer to the operating problems of the industry than the financial control groups; they are consequently more sensitive to expressions of consumer dissatisfaction and more apt to be alive to the industry's technical potentialities for expansion and services. But, while the technical imperatives of the industry may shape the professional standards of the operating managerial group, these standards, as Veblen has indicated, may come into fundamental conflict with the financial discipline imposed by the control groups. The position of the operating personnel as salaried employees who can be hired and fired at the pleasure of the control groups deprives them of any real independence of action. Whatever their private views of proper public policy may be, in their appearance before policy-forming tribunals and regulatory authorities, they echo the political views of the control groups and maintain a close community of interest with them.

Another important party-in-interest in the electrical utility industry is the investor. Thorstein Veblen in his *Theory of Business Enterprise* (1904) called attention to the divergence which may develop between the pecuniary interests of ordinary investors on the one hand, and of the insiders who dominate the strategic controls of the enterprise on the other. Experience in the utility holding company field furnishes numerous examples where insiders have utilized their position of control to exploit small investors. Consequently, it becomes important to distinguish between control groups who actually have power over the enterprise and the body of small investors whose ordinary role is the passive one of receiving or hoping to receive dividends and interest. This passive investor interest is not confined entirely to small individual investors. It may also embrace a variety of institutional investors such as colleges, foundations, banks, and insurance companies, though, of course, as the stake of the investing interest increases in magnitude the opportunity for the exertion of influence, if not of control, likewise becomes more promising.

Still another party-in-interest in the electrical industry is labor. Labor costs do not bulk large in this industry and, because of the character of the skills required, a large proportion of the labor force is relatively well paid. Until recently the industry was largely unorganized and strenuous efforts were made by management to consolidate the loyalty of their employees through paternalistic and welfare policies. As a result of the lack of independent organization on the part of employees, there was little evidence of efforts on their part to influence public policy. Regulatory statutes in the field focused on the interests of consumers or investors rather than on the interests of labor. With increasing organization, however, labor can be expected to prove a more potent force in the future, potent not only in pressing for an increased portion of the income stream of the industry as against other claimants, but also in seeking to shape general regulatory policy in this field.

Still another party-in-interest, and from the point of view of regulation perhaps the most important party-in-interest, is the consumer of electric power. As has already been indicated, the consumer interest on closer analysis breaks up into certain well-defined parts. There are the large industrial and commercial consumers; there are the smaller residential and commercial consumers; and there is also a frequently neglected group, the potential consumers who perhaps would like to use electricity but are denied the possibility because of

high rates, residence in sparsely populated rural areas, distance from transmission lines, or other reasons.

While consumers, in general, seek low charges and maximized consumption, all of them are by no means equally well placed to make their demands effective. As has already been pointed out, the large-scale industrial and commercial power users have bargaining advantages, since they can construct their own generating plants if company rates are too high. The small commercial, the residential, and the potential consumers are not so fortunately situated. Their remedies in the nature of the case must be political rather than economic, but they face serious obstacles in making their political influence effective. With numbers on their side, they are always a potential power to be reckoned with, but they are usually scattered and disorganized, and no machinery ordinarily exists for consolidating them into a coherent and effective political force. Their displeasure may express itself in periodic bursts of indignation which political leadership may capitalize, but this indignation easily exhausts itself and no effective device has yet been found for maintaining articulate consumer interest as a continuous regulatory force.

These groups, then—consumers, investors, management, labor, financial control groups, and allied interests—provide the raw material and the dynamic force from which a pattern of regulation, or perhaps lack of regulation, emerges. Each group puts forth its claims and seeks in varying degree to determine the content of public policy in the electricity field. A realistic analysis of the regulatory process must take account of the demands of these groups and the interplay of their rivalries.

2. The Development of Regulation of the Electric Power Industry

In analyzing the development of regulation in electricity there are interesting parallels to be drawn with the history of railroad regulation. As in the railroad field, public policy in the early stages of the industry was largely promotional. That is to say, the primary concern was to encourage the development of the industry. The emphasis was on aid rather than on restriction. Later, as abuses developed, particularly in the form of high rates, consumer-inspired dissatisfaction laid the groundwork for regulation. As in the railroad industry, regulation came after abuses had disclosed themselves and vested in-

terests had become entrenched, and not as a process guiding the development of the industry. As in the railroad industry, regulation lagged behind the developing geographical pattern of the industry. State-wide power was not effectively invoked until long after the industry had transcended local boundaries and, similarly, national power was not resorted to until long after the jurisdictional bounds of state regulation had been outstripped by the regional and national organization of the industry. As in the railroad industry, also, regulation remained for a long time negative in character—that is to say, it was concerned with discovering and penalizing abuses and checking excessive rates rather than with guiding and co-ordinating the policy of the industry. As in the railroad industry, too, the tendency has been for regulation to become more positive in character, concerned with reshaping the corporate structure of the industry, planning the development of new sources of supply, and controlling and directing the marketing policies of the industry.

At least three well-defined stages marked the development of regulation in electricity. The first period, from 1882, the date of the establishment of the first central electricity plant in the United States, until 1907, the date of the first effective effort to regulate electrical utilities through state-wide commissions, might be described as predominantly promotional, though elements of local regulation did appear. The second period, from 1907 until roughly 1933, was a period when chief reliance was placed on state regulatory commissions. In the third period, which was foreshadowed by the passage of the Federal Water Power Act in 1920, but which really did not gather momentum until the New Deal, national power was for the first time strenuously invoked to deal with the utilities. Concomitantly state regulation became more vigorous and effective. Each of these periods will be dealt with separately.

Of the first period, relatively little needs to be said. The parallel with the early days of the railroad industry is striking. Electrical utility promoters were commonly regarded as community benefactors to whom inducements had to be held out to encourage investment in what was still regarded as a risky and experimental industry. As a result, franchises of great prospective value were freely disposed of with little attempt to safeguard the future interests of the community. Regulation, such as it was, depended on the terms of the franchise or charter, or it derived from legislation, either municipal or state.

In either case it was of a minimal and ineffective character. Lack of regulation opened the way to abuse, and consumer complaints began to mount. It was charged that the utilities imposed excessive rates, overcapitalized their properties heavily, and realized extortionate profits. Consumer dissatisfaction led to a demand for more effective regulation. This demand culminated in the establishment of state commissions to regulate electrical utilities. The utilities fought this movement but were finally forced to capitulate as the popular clamor for more effective regulatory agencies became more insistent.

3. Regulation by State Commissions—Weaknesses

Starting in 1907 with the establishment of commissions in New York and Wisconsin and their rapid spread to other jurisdictions in the next years, there began an effort toward more effective state regulation. That effort did not prove to be notably successful. The utilities had fought the establishment of state commissions. Once the commissions were established, they determined, in the words of one spokesman, to "regulate the regulators." In that effort, they very largely succeeded. The history of the electrical utility industry in the period from 1907 until roughly the New Deal is the story not only of remarkable expansion of the industry itself; it is also a record of the rise of financial control groups to a position of ascendancy and concentrated economic power such as has rarely been witnessed.

This ascendancy had its inevitable reflection in the operation of the regulatory process during this period. Compared with the control groups and their financial allies, other parties-in-interest were relatively weak and ineffective. The expansionist character of the industry dissolved whatever theoretical doubts the conservative investor might have entertained about the lush growth of holding company structures. While dividend checks poured in and stock market quotations rose, the investor was only too content to be a passive income receiver and to give his wholehearted loyalty to the financial wizards who were so successfully lining his purse. Not until the depression brought some holding company structures tumbling down did doubts begin to arise. Consumers, meanwhile, were also difficult to stir into action. The relative prosperity of the period made it hard to excite consumers about electric rates. The general downward rate trend served to mitigate such consumer dissatisfaction as

existed. As a result, the consumer group, while numerically powerful, remained a negligible restraining force. Regulatory commissions lacked the dynamo to generate support for an aggressive regulatory program. Passivity and inertia among consumers inspired a similar attitude among commissions. Thus, the economic setting created a situation which was made to order for the control groups. They knew what they wanted—a minimum of effective regulation—and the vast economic resources which they controlled enabled them to attain their objective. By and large, they succeeded in carving out an area of independent sovereignty which left much of the state regulatory machinery an empty façade.

How was this result achieved? In the first place, intensive efforts were made to create opinion favorable to privately owned utilities and unfavorable to an extension of state regulation or public ownership. In the second place, utility interests sought to limit the scope and effectiveness of regulation by direct pressure on legislatures and administrative agencies. In the third place, appeals were taken to the courts when commission decisions on rates and valuations proved unsatisfactory. In the fourth place, vigorous steps were taken to prevent national regulation of interstate transmission of electric power. This increasingly important aspect of utility operation remained in the twilight zone where state regulation was unconstitutional and national regulation nonexistent. In the fifth place, the holding company was relied on as a method of rendering state regulation largely ineffective. Efforts to regulate holding company transactions were vigorously opposed.

PUBLIC RELATIONS CAMPAIGNS

In the post-World War I period, particularly, utilities embarked upon a vast so-called "educational" campaign, to "sell" their industry to the public and to convince the American people of the adequacy of existing regulatory techniques and of the dangers of further penetration of government into the utility business. It was estimated that the cost of this campaign ran from $25,000,000 to $30,000,000 a year —all charged off as proper operating expenses of the industry and computed in the rates which the public was required to pay. Utility executives were advised not to spare their "educational" budgets. As M. H. Aylesworth, then managing director of the National Electric Light Association, the trade association of the industry, put it: "All

the money being spent is worth while—don't be afraid of the expense. The public pays the expense." [1]

Equipped with ample resources, utility control groups embarked on an intensive organizational drive to win the loyalty of the various parties-in-interest involved in the regulatory process. Customers, investors, utility employees, and allied industries were to be persuaded to accept the interpretation of proper public policy which was set forth by the control groups. They were to be welded together in a united front of opposition to "destructive" governmental regulatory activity.

Consumers were wooed in a variety of ways. Intensive drives were undertaken to increase the proportion of customer stock ownership—much of it nonvoting stock—which was saluted at one and the same time as "the best kind of public ownership" and also as a means of "combating the growing tendency for public ownership." Security holders were organized for political purposes. As the managing director of the National Electric Light Association said: "Information directly submitted to the congressional representatives of the respective states as to the number of security holders within their particular state should be effective in emphasizing in their minds the importance to their local constituents of any matters which affect these securities." [2] Banks, insurance companies, chambers of commerce, and other businesses were mobilized to support the utility program. Utility employees were widely utilized in the campaign to present the utility case to the public. As one executive put it: "We have in our employees a great force which, properly informed and properly directed, can be of tremendous assistance in securing and maintaining right public relations." [3] "With the increased activities of some of our advocates of public ownership," stated an article prepared for the National Electric Light Association, "it is high time we mustered all of our employees, male and female, to demand their right to the rewards of individual initiative and endeavor, which will be theirs only under private operation." [4] Manuals were pre-

[1] From speech before the 13th Annual Convention of the Southeastern Division of the National Electric Light Association, 1925. Quoted in Federal Trade Commission, *Utility Corporations*, S.Doc. 92, 70th Cong., 1st Sess., Part 7, p. 129.

[2] Quoted from letter of Paul S. Clapp, managing director of the N.E.L.A., dated November 4, 1927. Federal Trade Commission, *Utility Corporations*, Part 71A, p. 12.

[3] *Ibid.*, p. 278.

[4] *Ibid.*, pp. 278–279.

pared and study courses and meetings held to equip utility employees, in the words of Samuel Insull, "to disseminate facts relating to the theories of political ownership and to help the industry from unjust and injurious attack." Utility employees were trained, in effect, to do missionary work on behalf of private ownership.

No possible channel of public opinion was neglected in the effort to instill in the general public an attitude harmonious with the wishes and program of the utilities. Efforts were made to win the good will of the press by advertising, "canned" handouts, and, where it seemed advisable or necessary, by outright purchase of organs of public opinion. The importance of the educational system as an opinion-forming agency was recognized. "The aim," according to the Illinois Committee on Public Utility Information, was "to fix the truth about the utilities in the young person's mind before incorrect notions become fixed there." [5] An elaborate program, ranging from special picture books for kindergartens to retainers for college professors, was formulated to achieve this purpose.

This well-organized campaign, directed by the utilities and financed out of funds supplied by the public, was designed to convince the public that the utility conception of public policy was the only proper conception of public policy. This was the view which the utilities sought to implant, and at least until the economic debacle of 1929–1933 they proved surprisingly successful. They made state regulation satisfactory to themselves because they largely succeeded in regulating the sources of public opinion from which regulation springs.

DIRECT PRESSURE ON LEGISLATURES AND COMMISSIONS

But utility efforts were by no means confined to manipulation of opinion. Where it promised to be efficacious, direct pressure on state legislatures and commissions was frequently exerted.

The effectiveness of the utility commission depends, in large measure, on the powers with which the legislature endows it. It is the legislature which determines whether the utility commission will be weak or strong, whether adequate financial provisions will be made for carrying on its work, whether it will have an adequate staff of engineers, accountants, or economists, whether they will be well paid or poorly paid, whether the jurisdiction of the commission will be limited or enlarged; whether the commission, for example, will

[5] *Ibid.*, p. 141.

have adequate power to control utility accounts and capitalization, scrutinize operating expenses, determine depreciation allowances, and regulate rates and services; in short, whether a commission will be reasonably effective or whether it will be helpless.

Utilities, therefore, have found it expedient to maintain lobbies in various capitols, to see that their interests are effectively represented and to make sure that no "harmful" legislation will be passed. Lobbying techniques are apt to be versatile. They may range from simple presentations of the utility point of view to expensive, elaborate, and assiduous entertainment of legislators, and even to retainers and direct employment of legislators by the utilities.[6] As a result of the successful employment of such tactics, legislative efforts to implement state regulation of electrical utilities were notably ineffective in the pre-1933 period. Even as late as 1934, when the Federal Power Commission made a survey of state control over public utilities, there were still twelve states in which commissions had no jurisdiction over electric utility accounting, eighteen states in which they had no jurisdiction over capitalization and securities, twenty-six states in which they had no jurisdiction over depreciation, and in seven states there was not even any jurisdiction over rates and services. These figures speak for themselves.

Regulation varied in effectiveness in different states. Some commissions, such as those in Wisconsin, New York, Massachusetts, Illinois, did reasonably good jobs under difficult conditions; but, by and large, the administrative performance of utility commissions was far from noteworthy. Utility commissioners, on the whole, were poorly paid. Their average tenure of office was brief, rarely reaching

[6] Here, for example, is a letter signed by W. T. Thayer, State Senator in New York and chairman of the Committee on Public Service, the committee through which all bills on utilities had to pass. The letter is dated March 28, 1927, and is addressed to S. J. Magee, Vice-President of the Associated Gas and Electric Company:

"In keeping with your instructions of March 22, regarding my expense account . . . I herewith hand you bill as suggested. . . .

"The legislature adjourned last Friday and I have now returned to Chateaugay and will be here most of the coming summer. If at any time I can be of further service to you, please do not hesitate to call on me. I hope my work during the past session was satisfactory to your company; not so much for the new legislation enacted, but from the fact that many detrimental bills which were introduced we were able to kill in my committee."

(*State of New York, Proceedings of the Judiciary Committee of the Senate in the Matter of Investigation Requested by Senator Thayer,* Legislative Document, 1934, No. 102, p. 464.)

beyond five years. The problems which they faced were often highly technical and complex. Commissioners, for the most part, were political appointees; they came to their task with little in the way of background and experience to prepare them for their work. Their staffs were usually inadequate and financial resources were limited. The budgets of the commissions were paltry compared with the resources available to the utilities in fighting regulation. Rate cases were expensive and drained the resources of commissions. As a result, many jurisdictions during the twenties took the position that their function was not to initiate crusades against the utilities, but to sit as a judicial tribunal to hear such consumer complaints as were brought to them. The weakness of the individual consumer under such a procedure can readily be visualized. The timidity of commissions reflected their inability to mobilize public support. Many of them were subject to temptations which it was difficult to ignore. With salaries small and tenure uncertain, it is easy to understand why some of them eventually found their way into the employ of the utility companies which they were formerly engaged in regulating.

Such undermining of morale made effective regulation difficult. But organizational weaknesses were by no means the only factor in the breakdown of regulation. In a more far-reaching sense, the commissions found themselves hamstrung by the fact that the companies which they were trying to regulate were escaping from their reach. The rates and valuations which they fixed could be appealed to the courts. As the technique of transmitting electricity over long distances developed, the resulting interstate traffic created another unregulated area which was immune from surveillance by state commissions. Furthermore, with the spread of the holding company, itself not subject to direct regulation, the utility commissions found themselves increasingly helpless to regulate the operating companies, which were theoretically subject to their jurisdiction.

THE ROLE OF THE COURTS

The role of the courts as ultimate arbiters in rate regulation contributed to a breakdown in the regulatory process. This role did not become immediately apparent. In *Munn* v. *Illinois* the Supreme Court laid down the fundamental proposition that rate regulation was a legislative matter and not reviewable by the courts. "For protection against abuses by legislatures," said Chief Justice Waite, "the

people must resort to the polls, not to the courts." [7] This decision was apparently based on the theory that rate regulation, even if it partook of the character of what might now be deemed confiscatory, did not really involve a "taking" of property. Property was still identified with physical assets.

Gradually the courts shifted their position. In the *Railroad Commission* cases it was suggested that "this power to regulate is not the power to destroy." [8] Here was an early intimation that statutory rates might be held violative of the Fourteenth Amendment if they were outrageously low. Soon thereafter, in *Chicago, Milwaukee, and St. Paul R.R. Co.* v. *Minnesota,*[9] the new doctrine began to flower. "The question of the reasonableness of a rate of charge for transportation by a railroad company," said the Court, "is eminently a question for judicial investigation. . . ." This question of what is a reasonable rate necessarily led to the further question of the basis on which reasonableness should be determined. In *Smyth* v. *Ames* [10] an attempt was made to vouchsafe an answer. "We hold," said the Court, "that the basis of all calculations as to the reasonableness of rates to be charged by a corporation maintaining a highway under legislative sanction must be the fair value of the property being used by it for the convenience of the public. . . . What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience."

Thus, the doctrine was developed that rates which yielded a material net income might still be enjoined if they were not sufficient to yield a "fair return on fair value." In other words the courts adopted a new doctrine of property. Property became value rather than mere physical assets, and the protection of the Fourteenth Amendment was extended to cover this new concept of property. Not only did the courts extend their protection against confiscation of values, but they eventually went one step further. They asserted the right to determine value, not only as a matter of law, but as a matter of fact. As Justice McReynolds said, in *Ohio Valley Water Company* v. *Ben Avon Borough,* "In all such cases [rate cases], if the owner claims confiscation of his property will result, the state

[7] 94 U.S. 113, 134 (1877).
[8] *Stone* v. *Farmers' Loan and Trust Co.,* 116 U.S. 307, 331 (1886).
[9] 134 U.S. 418 (1890).
[10] 169 U.S. 466 (1898).

must provide a fair opportunity for submitting that issue to a judicial tribunal for determination upon its own independent judgment as to both law and facts; otherwise the order is void because in conflict with the due process clause, Fourteenth Amendment. . . ."[11]

This doctrine did not go unprotested. An eloquent line of dissent pointed out that the application of this doctrine made findings of fact by qualified administrative agencies virtually meaningless and tended to transform the Supreme Court into a general appellate body for the revision of utility rates anywhere in the United States.[12] Justice Frankfurter in a recent case has added his voice to the protest.

> The determination of utility rates—what may fairly be exacted from the public and what is adequate to enlist enterprise—does not present questions of an essentially legal nature in the sense that legal education and lawyers' learning afford peculiar competence for their adjustment. . . . These are matters for the application of whatever knowledge economics and finance may bring to the practicalities of business enterprise. The only relevant function of law in dealing with this intersection of government and enterprise is to secure observance of those procedural safeguards in the exercise of legislative powers which are the historic foundations of due process.[13]

Meanwhile, however, the courts had taken upon themselves the task of evolving criteria of fair value. But how was fair value to be ascertained? The famous case of *Smyth* v. *Ames*[14] is the starting point for many difficulties. In that case, which involved railroad rates fixed by the Nebraska Legislature, the state legislature had made an effort to relieve the agrarian distress which resulted from the depression of 1893 by reducing railroad rates for farm produce. This reduction was challenged in the courts. It is worth noting that the case came up in a period of steadily declining prices and that the original cost of the railroads in question was considerably higher than would have been the reproduction cost at then current prices. The attorneys for the railroads, in arguing for a fair return on the value of their property, offered the original cost of the railroads as a measure of value. Counsel for the state urged the doctrine of re-

[11] 253 U.S. 287, 289 (1920).

[12] See Justice Brandeis's dissent in the *Ben Avon* case and his concurring opinion in *St. Joseph Stockyards Co.* v. *U.S.*, 298 U.S. 38 (1936).

[13] *Driscoll* v. *Edison Light and Power Co.*, 307 U.S. 104 (1939).

[14] 169 U.S. 466 (1898).

production costs and contended that the rates fixed by the state legislature were reasonable on the basis of present value of the railroad property. Justice Harlan, in deciding against the state, attempted to steer a middle course between these rival theories. The railroad was entitled to a reasonable return on the fair value of its property. But what was fair value?

In order to ascertain that value [said Justice Harlan] the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case.

But what weight each of these factors should be accorded Justice Harlan did not indicate. Legislatures and commissions were left to guess what would meet the favor of the Court in particular cases and, as if to make the problem even more confusing, Justice Harlan added, "We do not say that there may not be other matters to be regarded in estimating the value of the property."

With these highly indefinite and even conflicting criteria, the commissions were necessarily embarked on a voyage on uncharted seas. They had no compass to steer by, and their destination was subject to change without notice. They had to find out what the fair value of property really was, but specific directions were not vouchsafed them. The celebrated formula of *Smyth* v. *Ames* was a challenge to reconcile the irreconcilable.

In the years following the decision in *Smyth* v. *Ames,* the price level began to rise again. There was a slow upward incline up to about 1915. After that year, under the stimulus of war, the ascent became sharp and precipitous. As E. C. Goddard neatly put it, "In the nineties, cost of reproduction was far less than actual investment, however prudent; after 1900 it was increasingly greater than investment, however imprudent." [15] The result of this reversal of price movement was a concurrent reversal of positions by the utilities and the public. The utilities, which in *Smyth* v. *Ames* had sworn their fealty to original costs as a measure of fair value, were now increasingly embracing reproduction costs as that theory promised greater

[15] Association of American Law Schools. 2 *Selected Essays in Constitutional Law* (1938), p. 561.

advantages. Public representatives, on the other hand, found original cost or prudent investment more tempting.

In the period before the first World War the holdings of the Supreme Court did not clearly establish the predominance of any single factor in the determination of fair value. But the dicta of the Court tended to place great emphasis upon reproduction costs. In the first *San Diego* case (1899) Justice Harlan said: "What the company is entitled to demand, in order that it may have just compensation, is a fair return upon the reasonable value of the property *at the time it is being used for the public*" [16] (italics supplied). In the second *San Diego* case (1903) Justice Holmes cited this statement and added: "That is decided, and is decided as against the contention that you are to take the actual cost of the plant, annual depreciation, etc., and to allow a fair profit on that footing over and above expenses." [17] In the first *Consolidated Gas* case (1909) this attitude became even more clearly defined. Justice Peckham said: "The value of the property is to be determined as of the time when the inquiry is made regarding the rates. If the property, which legally enters into the consideration of the question of rates, has increased in value since it was acquired, the company is entitled to the benefit of such increase." [18] In the *Minnesota Rate* cases (1913), Justice Hughes gave further emphasis to this position. He said:

> It is clear that in ascertaining the present value we are not limited to the consideration of the amount of the actual investment. If that has been reckless or improvident, losses may be sustained which the community does not underwrite. As the company may not be protected in its actual investment, if the value of the property be plainly less, so the making of a just return for the use of the property involves the recognition of its fair value if it be more than its cost. The property is held in private ownership, and it is that property, and not the original cost of it, of which the owner may not be deprived without due process of law.[19]

While the Court continued to pay lip service to all the elements named in *Smyth* v. *Ames,* the utterances quoted above manifest an increasing tendency to give weight to reproduction cost. In the period before the first World War, the spread between original cost and cost of reproduction was not so great as to make the problem acute.

[16] 174 U.S. 739.
[17] 189 U.S. 439.
[18] 212 U.S. 19.
[19] 230 U.S. 352.

The rapid rise in prices during and immediately following the war created a very different situation. The utilities were quick to press for valuations which would give recognition to the greatly enhanced costs of labor, supplies, and construction. State utility commissions offered resistance, but the decisions of the Supreme Court in the postwar period for the most part represented a triumph for the contention of the utilities.

In 1923 the Supreme Court was called upon to consider the effect of the new price conditions in three important utility cases. In the first of these, *Southwestern Bell Telephone Co.* v. *Public Service Commission*,[20] Justice McReynolds, speaking for the majority, commented: "Obviously the commission undertook to value the property without according any weight to the greatly enhanced costs of material, labor, supplies, etc., over those prevailing in 1913, 1914, and 1916. As matter of common knowledge these increases were large. Competent witnesses estimated them as 45 to 50 percentum." The Justice added:

> It is impossible to ascertain what will amount to a fair return upon properties devoted to public service, without giving consideration to the cost of labor, supplies, etc., at the time the investigation is made. An honest and intelligent forecast of probable future values, made upon a view of all the relevant circumstances, is essential. If the highly important element of present costs is wholly disregarded, such a forecast becomes impossible. Estimates for tomorrow cannot ignore prices of today.

Justice Brandeis, in an opinion which has since become famous, concurred in the result because the rates fixed prevented the utility from earning a fair return on the amount prudently invested, but he seized the occasion to review the whole question of valuation, to demonstrate the legal and economic unsoundness of the so-called rule of *Smyth* v. *Ames,* and to set forth the merits of the theory of prudent investment. Justice Holmes concurred in the Brandeis opinion.

Several weeks later two important cases were decided. In the *Bluefield Waterworks* case [21] the Supreme Court reversed the Supreme Court of West Virginia, which had held that the rate base should be the actual amount of money invested. Justice Butler pointed out the necessity of according proper weight to the greatly enhanced

[20] 262 U.S. 276 (1923).
[21] 262 U.S. 679 (1923).

costs of postwar construction. The same day the Supreme Court also decided the case of *Georgia Railway and Power Co.* v. *Railroad Commission*.[22] This time Justice Brandeis wrote the opinion and the rates fixed by the Commission were upheld. Justice Brandeis attempted to distinguish the case from the *Southwestern Bell* decision. "Here," said the Justice, "the Commission gave careful consideration to the cost of reproduction; but it refused to adopt reproduction cost as the measure of value. It declared that the exercise of a reasonable judgment as to the present fair value required some consideration of reproduction costs as well as original costs, but that present fair value is not synonymous with present replacement costs." He added, "The refusal of the commission and of the lower court to hold that, for rate-making purposes, the physical properties of a utility must be valued at the replacement cost less depreciation was clearly correct." Justice McKenna dissented. He contended that the decision in the case could not be reconciled with the *Southwestern Bell* and *Bluefield* cases and that under the doctrine of the latter cases the order of the Georgia Commission should have been suspended.

These cases still revealed the Court's uncertainty in the face of the new conditions. By 1926, when prices seemed fairly stable, though on a level high above 1914, the Court evidenced a clearer intention to give great weight to reproduction costs. In that year a notable valuation case came before the Supreme Court, *McCardle* v. *Indianapolis Water Company*.[23] Justice Butler wrote the majority opinion and the language of his opinion was all that advocates of reproduction costs could wish for.

> Undoubtedly [he said] the reasonable cost of a system of water works, well planned and efficient for the public service, is good evidence of its value at the time of construction. . . . If the tendency or trend of prices is not definitely upward or downward and it does not appear probable that there will be a substantial change of prices, then the present value of the lands plus the present cost of constructing the plant, less depreciation, if any, is a fair measure of the value of the physical elements of the property.

In this case, however, it is worth noting that the company had agreed to accept a rate base of $19,000,000 although evidence indicated that

[22] 262 U.S. 625 (1923).
[23] 272 U.S. 400 (1926).

reproduction costs would have been materially higher. Again Brandeis wrote a dissent which was concurred in by Stone.

The next important pronouncement by the Supreme Court came in the celebrated *O'Fallon* case.[24] This time Justice McReynolds spoke for the majority. After a recitation of the cases from *Smyth* v. *Ames* to the *McCardle* case he reversed the valuation which had been made by the Interstate Commerce Commission largely on the basis of actual legitimate investment. He pointed out that the Commission had failed to give consideration to present-day reproduction costs. But he refused to proffer a definite guide for future action. "The weight to be accorded thereto [reproduction costs] is not the matter before us." Justices Brandeis, Holmes, and Stone dissented.

The effect of these pronouncements of the Supreme Court was to impose requirements on regulatory agencies which were disastrous to effective regulation. The fair value doctrine as interpreted by the Court offered no clear guide to action. The main difficulty with the fair value doctrine lay in the reproduction cost element. While valuations on the basis of reproduction cost were sometimes made necessary because it was impossible to ascertain original cost, the courts went further and required a finding as to reproduction cost even where data as to original cost were available. In arriving at estimated reproduction costs it was necessary to make a complete inventory of property and to appraise all the items in the inventory.

Uncertainties necessarily attended this process. Electric power properties may extend over enormous areas and values may run into billions of dollars. The task of merely listing, counting, measuring, or weighing all the items represented must be recognized as monumental. Moreover, when it is remembered that the physical conditions of all the properties visible and invisible must be reported in order that allowance may be made for so-called observed depreciation, it becomes clear that much depends upon opinion or even guesswork. Such opinions, even when made by so-called experts, disclose startling discrepancies. Nor is this the only difficulty. The pricing process reveals even sharper variations. Great strides have been made in recent years in devising new electrical equipment. Under the doctrine of reproduction cost old structures and old equipment must be valued "on the basis of what it would cost to reproduce them today even though they are not in fact being produced and would not be re-

[24] *St. Louis and O'Fallon Railway* v. *U.S.*, 279 U.S. 461 (1929).

produced under any imaginable circumstances." [25] Their present reproduction costs can be computed "only by some sort of legerdemain." [26] Virtually every unit price involved in the inventory is one of estimate rather than exact fact. The result is resort to conjecture and speculation, as the valuation experts of the utility companies strive for maximum reproduction costs and the representatives of the public press for minimum estimates. Since the valuation process requires the taking of field inventories and the pricing of myriad items, it cannot be accomplished in a short period of time. As a result, rate cases frequently stretch over long periods of years.[27] These long-drawn-out proceedings illustrate the futility of the fair value method of rate making. With fluctuations in prices constantly occurring, valuations may be obsolete almost immediately after they are determined. With no judicially recognized process by which valuations may be kept current, the regulatory process, for all practical purposes, becomes unworkable.

Still another factor contributing to the unworkability of the fair value rule is the enormous expense involved in making appraisals.[28]

[25] Pp. 37–38, Brief for the U.S., amicus curiae—*Driscoll* v. *Edison Light and Power Co.*, 307 U.S. 104 (1939).

[26] *Ibid.*, p. 41.

[27] The government brief in *Driscoll* v. *Edison Light and Power Co.*, pp. 47ff., points out numerous instances of delay:

The *Ohio Bell Telephone* case, 301 U.S. 292, was in process of adjudication about fourteen years. The Missouri Public Service Commission required over eight years to reach a determination in its proceedings against the Union Electric Light and Power Company, 17 P.U.R. (N.S.) 337; and over seven years in its proceedings against the Ozark Utilities Company, 18 P.U.R. (N.S.) 408. The North Dakota Board of Railroad Commissioners required almost three years in its proceedings against the Northern States Power Company, 15 P.U.R. (N.S.) 126. The New York Public Service Commission consumed at least five years in determining reasonable rates for the Long Island Lighting Company, 18 P.U.R. (N.S.) 65. . . .

The proceedings before the Illinois Commerce Commission to determine rates for the Illinois Bell Telephone Company, initiated in September, 1921, did not reach a final conclusion until twelve and a half years later, in 1934. See *Lindheimer* v. *Illinois Bell Telephone Co.*, 292 U.S. 151. More than ten of these years were consumed in litigation in the federal courts subsequent to the Illinois Commission's findings in the case. The *New York Telephone Company* case was instituted in 1920 and determined by the New York Public Service Commission in 1924; yet it was not until 1934 that the case was finally settled. See the concurring opinion of Justice Brandeis in *St. Joseph Stockyards Co.* v. *United States*, 298 U.S. 38, 90.

[28] These burdens have been graphically described by Harry Booth, General Counsel of the Illinois Commerce Commission, as follows:

"In connection with a case recently decided by the Illinois Commerce Commission,

The costly, long-drawn-out character of valuation proceedings tends to favor the utilities in their struggle against effective regulation.[29] As one Pennsylvania utility lobbyist put it, "The public will sooner

the Illinois Bell Telephone Company stated in its annual report that it had spent $1,200,000 in preparation of a state-wide appraisal, and this was subsequent to huge expenditures in the *Chicago Telephone* case. In proceedings before the same Commission involving the Commonwealth Edison Company of Chicago, the company's expenditures totaled approximately $1,000,000, a large part of which was for appraisals; and the People's Gas Light & Coke Company, also of Chicago, spent in excess of $750,000, more than $600,000 of which was for appraisal purposes. In Missouri, two recent cases involved expenditures, mostly for appraisal purposes, of over $900,000 by the Union Electric Company and nearly $300,000 by the Laclede Gas Light Company, including the Commission's expenses in both cases. . . . By some authorities it is stated that a complete reproduction cost appraisal may be expected to cost from one-half of a per cent to one per cent of the reproduction cost of the property in question. . . ." (Quoted in government brief, pp. 53–54, *Driscoll* v. *Edison Light and Power Co.*)

29 The following testimony before the New York Commission on the Revision of Public Utility Laws in 1930 illustrates a by no means uncommon situation:

"A case is brought before the Commission by complainants who put in such evidence as they can gather. As the public generally has little money available for the hire of experts, the evidence is probably meager. The company replies that it must have time to make a valuation of its plant to determine what it is entitled to earn. They take from two or six months, perhaps more. They present it with experts getting perhaps $200 a day. The public has not the resources to meet such a case but does the best it can. More time elapses while the public representatives attempt to consider and answer the company's evidence. Then the Commission attempts to digest some thousands of pages of evidence and makes its order.

"This does not end the case. If the Commission does not grant eight per cent on what the company claims as its valuation, the company appeals to the Federal Court. Some courts will act like a nickel in the slot machine, the company drops in its nickel and gets its injunction. A Master is to be appointed to take evidence and it may require months to agree on a Master Then the Master must try the case de novo. The complainants must spend more money to get experts and the company spends more money. The evidence goes to greater length than in the original case. Then the Master must decide the case himself, must review the great volume of evidence without a corps of assistants.

"Masters are generally inclined to the belief that if evidence is not contradicted it must be believed. That favors the utilities because they can put on witnesses to testify on matters concerning which the public representatives may have neither the knowledge nor the facts to refute. Probably another year elapses in this process and the Master makes his report. Then the statutory Court passes on the Master's report and renders its decision. All this takes time. Then there is an appeal to the Supreme Court, where you take your turn. The case is argued before the Supreme Court and decided. Perhaps five years have elapsed, conditions have changed, new values have been created to be adjudicated, and, besides, the Supreme Court cannot make rates. Only the Public Service Commission can make rates. So the whole proceeding may start over again." See *Report of Commission,* Legislative Document No. 75 (1930), at p. 272.

or later get tired of spending money for costs, and it is to our advantage to increase the costs." [30]

As a result of the difficulties created by protracted and expensive litigation, some commissions virtually abandoned formal proceedings as a method of securing rate reductions. Particularly after the onset of the depression in 1929, many of them turned to negotiation, hoping to secure reductions by mutual agreement. In some instances concessions were obtained, especially when the utility feared injury to its public relations if rate reductions were not forthcoming, or where it seemed probable that a formal proceeding would cut more deeply into utility profits than would a negotiated reduction. But, in most cases, negotiations were not especially successful, since utility companies preferred to stand on their legal rights.

In addition to negotiation, state commissions during the depression also turned to various short cuts in valuation methods in order to obtain prompt rate revisions. In some instances, an effort was made to avoid new appraisals by applying corrective price indexes to prior accepted valuations in order to arrive at present fair value. But this scheme also met legal obstacles. In *West* v. *Chesapeake and Potomac Telephone Company* [31] (1935) the Maryland Commission's attempt to use such a device was rejected by the Supreme Court as inappropriate. Whether the objection of the Court was only to the particulars of the price index plan used in this case, or whether it applied to any use of corrective price indexes in revising valuations, was not altogether clear from the opinion. In any case, the net effect was to encourage resort once again to the time-honored appraisal methods which had caused so much difficulty in the past.

Another device resorted to in the effort to secure prompt rate readjustments was the enactment of legislation authorizing utility commissions to issue temporary rate orders pending a final determination of "fair value." These statutes met bitter utility opposition, and their effective application was delayed by litigation. In *Bronx Gas and Electric Company* v. *Maltbie*, [32] however, the New York Court of Appeals upheld the New York statute which authorized the Commission to establish temporary rates based on original cost minus depreciation and which provided a recoupment procedure to protect utilities against losses which might result from the establish-

[30] *Ibid.*, p. 273.
[31] 295 U.S. 662.
[32] 271 New York 364, 3 N.E. [2nd] 512 (1936).

ment of confiscatory temporary rates. A similar Pennsylvania statute, enacted in 1937, was upheld by the Supreme Court as constitutional, in *Driscoll* v. *Edison Light and Power Co.*[33] (1939).

While the decisions of the Supreme Court since 1933 evidence some tendency to restrict the more extravagant claims of the utilities to "fair value," and thus inferentially lighten the burden of commission regulation, there is as yet no conclusive evidence that the Court is prepared to throw the fair value rule overboard and to adopt prudent investment as the basis of regulation. Thus, in *Los Angeles Gas and Electric Corporation* v. *Railroad Commission of California*[34] (1933), while the majority of the Court, speaking through Chief Justice Hughes, upheld the rate base established by the Commission and rejected utility claims for "going value," the Court still reverted to the rule of *Smyth* v. *Ames* as the test of confiscation. The next year, in *Lindheimer* v. *Illinois Bell Telephone Co.*,[35] the Supreme Court again upheld the state commission. The Court pointed out that the rate reduction ordered would not bring about confiscation and that "the questionable amounts annually charged to operating expenses for depreciation are large enough to destroy any basis for holding that it has been convincingly shown that the reduction in income through the rates in suit would produce confiscation." But again no effort was made to challenge the fair value rule itself. In *West* v. *Chesapeake and Potomac Telephone Co.*,[36] where, as noted above, a short-cut, corrective index valuation scheme was rejected, the fair value rule as embracing both historical cost and cost of reproduction was staunchly reaffirmed. In *Railroad Commission of California* v. *Pacific Gas and Electric Co.*[37] (1938) a vigorous effort was made to commit the Court to the prudent investment basis of regulation. The Court, however, limited its opinion to a finding that the Commission's order which was premised on a historical cost rate base did not constitute a denial of due process. The question as to whether the rates themselves were confiscatory was referred back to the District Court for a finding. Shortly thereafter, on September 8, 1938, the

[33] 307 U.S. 104. In this case the Court still paid lip service to the "fair value" rule of *Smyth* v. *Ames*. To Justice Frankfurter, concurring in a separate opinion, the Court's opinion appeared "to give new vitality needlessly to the mischievous formula for fixing utility rates in *Smyth* v. *Ames*."

[34] 289 U.S. 287.

[35] 292 U.S. 151 (1934).

[36] 295 U.S. 661 (1935).

[37] 302 U S. 388.

District Court found that "the charge of confiscation was not sustained by the record."

The Supreme Court itself, meanwhile, avoided a revision of the fair value rule. In *Driscoll* v. *Edison Light and Power Co.*, another strenuous effort was made to persuade the Court to renounce fair value and to give its explicit support to prudent investment. But again the effort proved unsuccessful. At the beginning of 1941 the confusing criteria of *Smyth* v. *Ames* still awaited clarification.

On the whole, the record of judicial participation in rate making has not been a happy one. In the effort to protect investors against "confiscation," the courts have assumed regulatory responsibilities for which they are ill fitted and have contributed to the ineffectiveness of public utility regulation. Effective regulation implies the ability to make quick adjustments in rates with cyclical fluctuations and technical progress. It further implies a close study of operating costs so that inefficiency can be eliminated and efficient management encouraged. It demands an awareness of the marketing problems of the electrical industry so that new uses can be discovered and consumption of electricity encouraged. The courts are obviously not equipped to perform these functions with promptness and dispatch. They do not have the expert technical facilities on which to base an intelligent judgment. Adequately staffed and competently manned commissions may at least make the effort. But they can make the effort successfully only if the courts provide intelligible legal criteria which permit the commissions a sphere of discretion in which experts can operate.

THE PROBLEM OF INTERSTATE TRANSMISSION OF ELECTRIC POWER

Still another contributing factor in explaining the impotence of state regulatory commissions was the growing importance of interstate transmission of electric power. This development furnishes an excellent example of how technological change serves to nullify old regulatory devices and to make new regulation imperative. At one time municipal regulation of electrical utilities was adequate, since the business of the early lighting companies was almost entirely confined to municipalities. Later, as the electrical industry shifted from the use of direct to alternating current and improvements were developed which made long-distance transmission possible, large light and power systems began to extend their field of operations. The economic changes involved in this technological advance made state-

wide regulation imperative. But, as the industry developed further and spread across state lines, state regulation proved increasingly inadequate.

A generation ago interstate transmission of electric power was hardly a problem. By 1928, however, 11.7 per cent of all power generated was transferred across state lines. By 1933, the figure had increased to 17.8 per cent. Meanwhile, the Supreme Court, in a series of important decisions, had determined that a state had no authority to regulate the wholesale distribution of power across state lines, since to do so would be to place a burden on interstate commerce. In *Missouri* v. *Kansas Natural Gas Co.*[38] (1924) it decided that the wholesale rate charged a local gas-distributing company by an interstate company was beyond the jurisdiction of the state commission having jurisdiction over the local company. Here the receiving state had attempted to exercise jurisdiction. In *Public Utilities Commission of Rhode Island* v. *Attleboro Steam and Electric Company*[39] (1927), the forwarding state tried to exercise jurisdiction. In this case the Rhode Island Commission attempted to increase the wholesale rates charged by the Narragansett Electric Lighting Company, a Rhode Island corporation, to the Attleboro Company, a Massachusetts corporation, on the theory that the low rates charged the Attleboro Company constituted a burden on Rhode Island consumers. The Supreme Court, with Justice Brandeis dissenting, held that the case was controlled by the *Kansas Gas Company* case and that the attempted Rhode Island regulation was, therefore, invalid as a direct burden on interstate commerce. The result of these decisions was to create a no man's land where the states could not act and where the federal government had not yet acted. Efforts were made to close this gap during the twenties by invoking federal power; but these efforts were strenuously and successfully opposed by the utilities. The gap remained open until the passage of the Federal Power Act of 1935.

THE PROBLEM OF THE HOLDING COMPANY

Yet another factor which contributed to the ineffectiveness of state regulation of electrical utilities was the difficulty of regulating the utility holding companies which developed during this period. One of the great anomalies connected with state regulation of utilities

[38] 265 U.S. 298.
[39] 273 U.S. 83.

lies in the fact that while, with one hand, states endeavored to extend their control and make it more effective, with the other many of them seemed to be doing their best to ensure that control would be ineffective. As states engaged in a competitive race to relax corporate restrictions, holding company organizers were able to create corporate structures so vast and so complex as to pass inevitably beyond effective state control.

Whatever the motive in the development of the holding company systems, whether to achieve operating economies, to obtain easier access to the capital markets, to eliminate competition, to increase profits, or to obtain inexpensive control of vast corporate assets, the result was to frustrate the possibility of effective state regulation of the underlying operating companies. State regulatory agencies encountered great difficulty in exercising control over operating companies whose policies were determined by corporate officials outside the jurisdiction of the states. The maze of intercorporate transactions in which such operating companies were enmeshed was frequently exempt from scrutiny or control.[40] The efforts of state

[40] As the New York Public Service Commission pointed out in *Re New York State Electric and Gas Corporation,* II P.U.R. 1932 E–1–45, at pp. 3, 4:

"Twenty-five years ago, the holding company was in an embryonic stage and was used principally for the purpose of centralizing control. In recent years, particularly during the last decade, the holding company idea has been utilized to siphon funds from operating utilities into holding companies or their subsidiaries and affiliates which are not subject to public regulation; and, in certain instances, funds have been diverted even from the holding companies to the pockets of individuals. Payments made to unregulated companies which operate no public utilities have been charged to operating expenses and frequently so submerged that the fact of such payments and the amount thereof do not appear in any report to stockholders or to regulatory bodies. By such means, operating expenses have been inflated, true profits have been hidden, and regulation of rates has been made extremely difficult. . . .

"Management, construction, service, interbuying and selling, auditing, material purchasing, and like services honestly and efficiently performed by one central organization for a group of similarly situated operating utilities might possibly result in lowered costs to operating utilities. When this is not accomplished, however, and when those who own and control the holding company or the operating utilities also own and control various auxiliary and affiliated corporations and companies, it becomes possible to undermine the operating utilities, to dissipate their profits and surplus, and so to impair their financial standing as to destroy their ability to raise funds for their local needs. . . ."

These and other questionable practices indulged in by some holding company promoters are fully documented in the elaborate investigation of utility holding companies begun by the Federal Trade Commission in 1928. See Senate Doc. 92, 70th Cong., 1st Sess.

commissions to exercise supervision over the intercorporate transactions of operating companies subject to their jurisdiction encountered great difficulty. The holding companies themselves were largely immune from regulation. The fees which they imposed were part of the operating expenses of the operating companies and reflected themselves in the rate structure. Though these fees were frequently determined without arm's-length bargaining, state commissions found it difficult to question their propriety, since the commissions ordinarily lacked control over the holding companies and had no access to their records.

Nor were the courts particularly helpful. In *Missouri ex rel. Southwestern Bell Telephone Co.* v. *Missouri Commission*[41] (1923) Justice McReynolds rebuked the effort of the Missouri Commission to reduce certain fees paid under a license contract between the American Telephone and Telegraph Company and its subsidiary, the Southwestern Bell Telephone Company. "It must never be forgotten," said the Justice, "that, while the state may regulate with a view to enforcing reasonable rates and charges, it is not the owner of the property of public utility companies, and is not clothed with the general power of management incident to ownership." This dictum was later qualified in *Smith* v. *Illinois Bell Telephone Co.*[42] (1930), where the Supreme Court requested the lower tribunal to make a specific finding as to whether the fees charged to operating companies for services bore a reasonable relation to the cost to the holding company of furnishing these services.[43] The more recent trend of Court decisions opened the way to somewhat closer scrutiny of operating expenses, particularly with reference to intercompany payments, but really effective regulation of holding company transactions remained difficult until the enactment by Congress of the Public Utility Holding Company Act of 1935.

The second period of electrical utility regulation—the period in which chief reliance was placed on state regulatory commissions—thus disclosed many weaknesses and difficulties. Holding companies

[41] 262 U.S. 276.

[42] 282 U.S. 133.

[43] A commission's right to inquire into payments to affiliated companies not themselves subject to its jurisdiction was definitely upheld in *Western Distributing Co.* v. *Public Service Commission of Kansas,* 285 U.S. 119 (1932). Justice Roberts ruled that where both parties to the service transaction constituted in effect a single business enterprise, scrutiny by the commission of double profits and intercompany charges was prerequisite to a satisfactory consideration of the reasonableness of retail rates.

were subject to inadequate supervision, and, as a result, the operating utilities which were under their control escaped effective regulation. Interstate transmission of electric power was immune from state regulation. The role of the courts in the rate-making process impeded effective regulation. Utility control groups were successful in limiting the scope and incidence of legislative and administrative action and in persuading large sections of the public to accept the view that any strengthening of public control was reprehensible. Analyzed in terms of the fortunes of various parties-in-interest during this period, it seems clear, on the whole, that the balance of power was heavily in favor of the utility control groups, with whom other financial interests, management, and allied industrial interests maintained a close community of interest. Up to 1929, there was relatively little evidence of consumer or investor dissatisfaction.

4. New Deal Power Policy

After the financial crash of 1929, complaints began to mount from both consumers and investors. While business collapsed, unemployment increased, mass purchasing power shrank, and prices in competitive areas declined, the price of electricity remained practically unchanged. Consumer demands for rate reductions went largely unheeded. The pressure on state public utility commissions to reduce rates increased tremendously, but, for the most part, the state regulatory agencies showed themselves unable to afford prompt relief. The weaknesses of existing regulatory practice were strikingly revealed, and the consumer demand for more effective public controls increased in intensity. Evidences of investor dissatisfaction were also soon apparent. With the Insull crash, the debacle of other inflated holding company structures, and revelations that investors were duped and exploited by holding company "insiders," a cleavage of interest between the "insiders" or the control groups, on the one hand, and the body of small investors, on the other, became manifest. Investors, too, began to add their voices to the growing demand for more effective regulation of the electric power industry.

It was this dissatisfaction—as felt and vocalized by large groups of consumers and investors—that expressed itself in the political overturn of 1932 and provided much of the drive and momentum behind the vast expansion of regulatory authority under the New Deal. The new administration declared that it was formulating its power policy

to protect the interests of consumers and small investors. It set out deliberately to curb the power of the financial control groups who had hitherto dominated the industry. As might be expected, the strongest hostility to the power policy of the Roosevelt administration developed among the latter groups. While the administration forces sought to consolidate the support of consumers and small investors, the financial control groups endeavored to drive a wedge between them by presenting the power policy of the administration as a threat to all utility investors. Against this background of struggle a new pattern of regulation emerged.

The characteristic feature of this third period in the history of electrical utility regulation is the entrance of the national government into the field on a major scale. To a certain extent, the beginnings of national regulation were foreshadowed by the passage of the Water Power Act of 1920 and the creation of the Federal Power Commission, but the real significance of national regulation did not really become evident until the New Deal. As the New Deal power policy crystallized, certain main directions became more clearly apparent. In the first place, the utilization of water-power resources under the jurisdiction of the federal government was subject to stricter supervision than had been the case under the Water Power Act of 1920. The latter Act was amended to vest increased authority in the Federal Power Commission. In the second place, a gap in the existing regulatory structure was closed by endowing the Federal Power Commission with power to regulate interstate transmission of electric power. In the third place, an effort was made for the first time to plan and co-ordinate the further development and use of power facilities and resources. The initiative in formulating such a plan was vested in the Federal Power Commission.

In the fourth place, an effort was made to decrease the power of the financial control groups by providing, in the Public Utility Holding Company Act of 1935, for the simplification of holding company structures. The same act also made provision for stringent regulation of holding company activities in the interest of consumers and investors. In the fifth place, stress was placed on building up and increasing the strength of the publicly owned sector of the power industry. T.V.A., Bonneville, and other large power projects testified to this trend, as well as the smaller municipal power plants financed through P.W.A. grants and loans. Public competition was relied upon to reduce rates and stimulate consumption in the private as well as

in the public sector of the industry. Efforts were also made to encourage utilization of electric power through the Electric Home and Farm Authority, which financed the sale of electric appliances. In the sixth place, great emphasis was placed on rural electrification. The Rural Electrification Administration was set up with power to lend money to help in the establishment of rural electrification projects, preferably co-operatives or other public projects. In the seventh place, an effort was made to supplement and strengthen existing state regulation of electrical utilities by making the information, facilities, and aid of federal power agencies available to the states.

5. Federal Power Commission—Background and Development

The movement for the conservation of national water-power resources and their development under federal control and regulation antedates the New Deal. But before that movement became really effective some of the best power sites in the public domain had been practically given away. The national government was slow to assert control over water-power developments on public lands and reservations and navigable waters of the United States. Prior to 1896, land patents in the public domain were issued without any special recognition of potential hydroelectric uses. Not until 1890 was specific Congressional authorization required for the construction of dams on navigable streams subject to the jurisdiction of the United States, and not until 1906 did Congress pass the first General Dam Act by which plans for water-power developments on navigable streams had also to be approved by the chief of army engineers and the Secretary of War, who could make special stipulations in the interest of navigation.

Beginning about 1905 the issue of federal control of future hydroelectric developments became acute. With the growth of the conservation movement, the existing Congressional policies which regulated the disposition of water-power sites were subject to severe criticism.[44] During the next decade the struggle over water-power legislation continued. On the one side were the conservationists demanding

[44] "We are now," said President Theodore Roosevelt, in vetoing the Rainey River Bill in 1908, "at the beginning of great development in water power. Its use through electrical transmission is entering more and more largely into every element of the daily life of the people. Already the evils of monopoly are becoming manifest; already the experience of the past shows the necessity of caution in making unrestricted grants of this great power.

strict regulation of water-power grants along the lines marked out by President Roosevelt in his Rainey River Veto message. On the other side were the power interests demanding freedom from control. The latter sought to muster public support by mobilizing states

"The present policy pursued in making these grants is unwise . . . in place of the present haphazard policy of permanently alienating valuable public property we should substitute a definite policy along the following line:

"First, There should be a limited or carefully guarded grant in the nature of an option or opportunity afforded within reasonable time for development of plans and for execution of the project.

"Second, Such a grant of concession should be accompanied, in the act making the grant, by a provision expressly making it the duty of a designated official to annul the grant if the work is not begun or plans are not carried out in accordance with the authority granted.

"Third, It should also be the duty of some designated official to see to it that in approving the plans the maximum development of the navigation and power is assured, or at least that in making the plans these may not be so developed as ultimately to interfere with the better utilization of the water or complete development of the power.

"Fourth, There should be a license fee or charge which, though small or nominal at the outset, can in the future be adjusted so as to secure a control in the interest of the public.

"Fifth, Provision should be made for the termination of the grant or privilege at a definite time, leaving to future generations the power or authority to renew or extend the concession in accordance with the conditions which may prevail at that time." (*Congressional Record,* 60th Cong., 1st Sess., pp. 4698–4699.)

This manifesto of the conservation movement was followed by a second Rooseveltian blast in the James River Veto Message of 1909:

"The great corporations are acting with foresight, singleness of purpose, and vigor to control the water powers of the country. They pay no attention to State boundaries and are not interested in the constitutional law affecting navigable streams except as it affords what has aptly been called a 'twilight zone,' where they may find a convenient refuge from any regulation whatever. . . . They are demanding legislation for unconditional grants in perpetuity of land for reservoirs, conduits, powerhouses, and transmission lines to replace the existing statute which authorized the administrative officers of the Government to impose conditions to protect the public when any permit is issued. Several bills for that purpose are now pending in both Houses. . . .

"The new legislation sought in their own interest by some companies in the West, and the opposition of other companies in the East to proposed legislation in the public interest, have a common source and a common purpose. Their source is the rapidly growing water-power combination. Their purpose is a centralized monopoly of hydroelectric power development free of all public control. It is obvious that a monopoly of power in any community calls for strict public supervision and regulation.

"I esteem it my duty to use every endeavor to prevent this growing monopoly, the most threatening which has ever appeared, from being fastened upon the people of this nation."

(H. Doc. 1350, 60th Cong., 2nd Sess.)

rights sentiment against the expansion of federal power and by capitalizing the desire of the South and the public domain states of the West for rapid water-power development.

After a protracted struggle the Federal Water Power Act of 1920 was enacted. Although ostensibly a victory for the forces struggling for vigorous control, it bore many marks of compromise and its administration was to disclose serious weaknesses. Under the terms of this statute, a Federal Power Commission composed of the Secretaries of War, Interior, and Agriculture—all serving ex officio—was established, with the authority to license water-power developments on public lands, on reservations, or on any navigable waters, subject to the jurisdiction of the national government. Licenses could be granted to either public agencies or private interests, though the Act provided for preferences to states or municipalities where the plans of the latter seemed equally well adapted to conserving and utilizing the navigation and water resources of the region.

The Act provided for a maximum license period of fifty years. At the end of the fifty-year period, the government reserved the right of recapture on payment to the licensee of its net investment in the property. The Act also prescribed a system of accounting for licensees. These accounting requirements were designed to facilitate the determination of the actual legitimate costs of each project and to ensure against write-ups or other inflation of the capital structure. Provision was also made for the payment of reasonable annual charges to the national government to cover the cost of administration of the Act and for use of government land and property. Where the rates, services, and securities of the licensee were not subject to state regulation, these regulatory functions were entrusted to the Federal Power Commission.

The pre-New Deal history of the Federal Power Commission indicated little disposition on the part of that body to utilize its regulatory authority with vigor or effect. The Commission was subject to considerable pressure from the power interests, and it was not prepared to resist such pressure. The administrations in office during the post-World War I decade were not in favor of stringent regulation, and the personnel of the Commission reflected the dominant sentiment of the period. Laxity in interpreting and enforcing the Act was manifest. The work of the Commission was also hampered by faulty organization and administrative difficulties. An ex-officio Commission, composed of Cabinet officers with numerous other responsi-

bilities, worked badly. Personnel was inadequate; the Commission was forced to depend in large part upon employees loaned by the War, Interior, and Agriculture Departments, and these were for the most part poorly equipped to perform the specialized engineering and accounting work required by the Act. Because of these difficulties, the Commission was reorganized in 1930 as an independent body of five full-time members who were empowered to recruit their own staff. But the Commission continued to be embroiled in difficulties. Its membership was predominantly conservative, and its views on water-power policies were subject from the start to severe criticism by Senate progressives.

With the coming of the New Deal, changes were made in the leading personnel of the Commission, and a new conception of the Commission's powers and responsibilities began to emerge. This new spirit was soon evident in a tendency to subject licensees to much more rigorous supervision, particularly in controlling accounting practices and in the determination of the actual legitimate costs of license projects. This type of activity was important since the future exercise of recapture rights by the government is dependent on accurate determination of cost data. The new spirit was also evident in a tendency to press for the extension of the jurisdiction of the Commission over water-power developments on nonnavigable tributaries of navigable waters where it could be demonstrated that interstate commerce was affected.[45] The Commission also sought to breathe life into the statutory preference for public rather than

[45] See *U.S.* v. *Appalachian Electric Power Co.,* S.Ct. 291 (1940), where the concept of navigability received a broad construction by the Court. "To appraise the evidence of navigability on the natural condition only of the waterway," said Justice Reed, "is erroneous. Its availability for navigation must also be considered. . . . The power of Congress over commerce is not to be hampered because of the necessity for reasonable improvements to make an interstate waterway available for traffic . . . nor is it necessary for navigability that the use should be continuous. . . . It is well recognized, too, that the navigability may be of a substantial part only of the waterway in question. . . ."

In this case the Court also expressed a broad view of the Federal Power Commission's authority to license water-power developments. In the words of Justice Reed, "The point is that navigable waters are subject to national planning and control in the broad regulation of commerce granted the Federal Government. The license conditions to which objection is made have an obvious relationship to the exercise of the commerce power. Even if there were no such relationship the plenary power of Congress over navigable waters would empower it to deny the privilege of constructing an obstruction in those waters. It may likewise grant the privilege on terms. . . ."

private developments of water-power resources. As a result of a number of clarifying amendments to the Act of 1920, embodied in the Federal Power Act of 1935, the control of the Commission over water-power resources was reinforced and the supervision of licensees effectively buttressed.

The Federal Power Act of 1935 also provided for a very considerable extension of the authority of the Commission into new fields. Federal regulation of interstate transmission of electrical energy was established, and the Commission was also vested with certain powers to bring about co-ordination of electrical properties through interconnection of facilities and interchange of energy.

The new powers of the Commission over utilities engaged in interstate commerce are extensive. The Commission may fix wholesale rates and charges in connection with the transmission of electricity subject to its jurisdiction. It is also empowered to regulate security issues and assumptions of corporate liabilities by utilities which are engaged in interstate commerce and which are not regulated by state commissions. Utility companies which come under its jurisdiction are also subject to regulation of mergers and sales of property, interlocking directorates, services, accounts, records, and depreciation.

The new authority of the Federal Power Commission over interstate electrical activities and the power to regulate the transportation and sale of natural gas in interstate commerce, conferred on it by the Natural Gas Act of 1938, close an important gap in the regulatory structure.[46] The Commission is now vested with the power to prevent interstate companies from charging exorbitant wholesale rates to intrastate distributing companies. It can also prevent interstate companies from discriminating in favor of consumers in one state at

[46] The Natural Gas Act of 1938 vests the Federal Power Commission with important powers. Natural gas companies subject to the Act are required to file rate schedules with the Commission and may not change such schedules without the approval of the Commission. The Commission may order changes in rates, but may not order an increase unless the increase is embodied in a schedule filed by the company. The Commission may order an extension of facilities and may require physical connection with local distributors if the Commission finds that no undue burden is placed on the natural gas company ordered to make the extension or interconnection. Commission approval is required both for abandonment of interstate facilities and for voluntary extension of facilities. The security transactions of officers of natural gas companies are subject to regulation. The Commission is given power to prescribe a uniform system of accounts and to determine the actual cost of and depreciation in the property of natural gas companies. It is also authorized to control exports and imports of natural gas and to co-operate with state regulatory agencies through the establishment of joint boards.

the expense of consumers in another state. The Act does not, however, give the Federal Power Commission any direct authority over local rates for electrical service; the exercise of that power is reserved to the states. The Federal Power Act of 1935 was intended to supplement rather than supersede state regulation. The Act contains provisions designed to make state regulation more effective, and to provide a basis for co-operation between state and federal commissions where necessary.

The Act contains significant provisions for aid to state regulatory authorities. On the request of a state commission, the Federal Power Commission is authorized to investigate and determine the cost of generation or transmission of electrical energy by companies subject to its jurisdiction. In fact, the Act specifically states that the Commission may turn such information over to a state utility commission, as well as other information and reports which may be of assistance in state regulation of electrical utilities. It may, on the request of a state commission, lend its experts for use in state proceedings. There is a further provision in the Act which authorizes the Commission to investigate and ascertain the actual legitimate cost of the property of every public utility subject to its jurisdiction. Such information may not only further more efficient state regulation of rates, but may also be of considerable importance in connection with regulation of the issuance of securities, mergers, and consolidations. In the endeavor to carry out these responsibilities and render effective aid to state regulatory agencies, comprehensive and authoritative factual data concerning all aspects of the power industry have been assembled by the staff of the Commission and made widely available to state agencies, municipalities, and consumers.

The Commission has also endeavored to perfect co-operative procedures with the state commissions in order to prevent duplication, overlapping, and conflict. The Act authorizes the Commission to hold joint hearings or conferences with any state commission concerning matters of common interest. It provides for the establishment of joint boards and agreements in order to standardize regulations. These co-operative procedures have already been widely used in adjusting the regulatory pattern to the demands of the federal system. Until recently the most notable example of duplicate state and federal regulation occurred in connection with accounting regulations. Efforts to introduce national uniformity in this field have already begun to bear fruit. The Federal Power Commission, collaborating with the

National Association of Railroad and Utilities Commissioners, has worked out a uniform system of accounts which has already been widely adopted by the states. Experience thus far would seem to indicate no insuperable difficulties in the way of adjusting the respective jurisdictions of the Federal Power Commission and the state agencies. There is already considerable evidence that the aid given by the Commission to state agencies has been of considerable service in making state regulation more effective.

Another aspect of the Federal Power Act is even more positive and ambitious. The Act entrusts the Federal Power Commission with the function of planning an interconnected and co-ordinated power system. The Federal Power Commission is directed to divide the country into regional power districts and to encourage interconnection within and between these districts. It is worth noting, however, that such interconnections, except in certain special cases, are to be voluntary. The function of the Commission is to promote and to encourage, rather than to compel, and in arranging its regional districts it is required to consult with the state commissions concerned. Upon application by a state commission or by an electric utility company, the Commission may order a company subject to its jurisdiction to provide additional interconnection for the sale of power in interstate commerce; but such an order may be issued only if the Commission finds such action necessary or appropriate in the public interest and if no undue burden is placed upon the public utility concerned. The Commission may not compel the enlargement of generating facilities for the purpose of interchanging power nor may it compel the public utility to sell or exchange energy, if to do so would impair the company's ability to render service to its own customers. The Commission also has authority to prohibit exports of electricity to a foreign country.

It must be recognized that the Federal Power Commission faces great difficulties in achieving its interconnection and co-ordination program under normal, peacetime conditions. If primary reliance be placed on voluntary interconnections, it seems likely that such interconnections will be made not because they fit into the master plan of the Commission, but because they serve the self-interest of the companies undertaking such interconnections. Where electric facilities are under separate ownership and intercompany jealousies and rivalries prevail, a voluntary interconnection program is bound to encounter serious obstacles. Indirectly the Commission, by virtue of its

authority over the transfer of facilities by sale or merger and over the acquisition of securities of one company by another, may be able to foster and promote a certain amount of co-ordination. But such authority is necessarily piecemeal in its application.

In case of war or emergency, however, the Commission's power to compel interconnection is much broader and is limited only by the provision that its orders must "best meet the emergency and serve the public interest." In accordance with a letter of the President of June 14, 1940, the Commission at a special meeting on June 15, 1940, authorized its chairman to organize the staff for national defense duties. "Under authority of the Federal Power Act, a specially qualified National Defense Power Unit was set up within the organization to survey defense-power needs and provision for meeting those needs, and to co-operate with the National Power Policy Committee and the Advisory Commission to the Council of National Defense in assuring an adequate and dependable power supply in case of emergency." [47]

6. Regulation of Holding Companies

Federal control of public utility holding companies was preceded by elaborate investigation and recommendations. In 1928 the United States Senate ordered the Federal Trade Commission to make a comprehensive investigation of the public utility industry. The Commission accumulated over eighty volumes of testimony and materials.[48] Subsequently the House Committee on Interstate and Foreign Commerce also sponsored a study of holding companies which was directed by Dr. Walter M. W. Splawn.[49] In July, 1934, President Franklin D. Roosevelt announced the organization of a National Power Policy Committee, headed by Secretary Ickes, with instructions to bring in, among other things, recommendations with reference to holding company legislation. In March, 1935, the Committee made public its report to the President. The report and the covering letter which President Roosevelt sent in transmitting the report to Congress reveal four general objectives which the Administration had in mind in bringing forth the holding company legislation.

[47] *U.S. Government Manual,* Fall, 1940, p. 104.

[48] S. Doc. 92, 70th Cong., 1st Sess., made pursuant to S. Res. 83.

[49] See *Report on the Relation of Holding Companies to Operating Companies in Power and Gas Affecting Control,* H. Rep. 827, 73d Cong., 2nd Sess.

(1) The proponents of legislation were eager to diminish the concentration of control in the electric and gas industries. "By 1932," the Committee's Report pointed out, "thirteen large holding company groups controlled three-fourths of the entire privately owned electric utility industry, and more than forty per cent was concentrated in the hands of the three largest groups—United Corporation, Electric Bond and Share Company, and Insull." This concentration was referred to by the Committee as dangerous to democracy. Pervading the report was the fear of bigness, fear of the Money Power, a Brandeisian yearning for independent enterprise which was expressed by President Roosevelt in his remark "that we should take the control and the benefits of the essentially local operating utility industry out of a few financial centers and give back that control and those benefits to the localities which produce the business and create the wealth. We can properly favor economically independent business, which stands on its own feet and diffuses power and responsibility among the many, and frowns upon those holding companies which, through interlocking directorates and other devices, have given tyranical power and exclusive opportunity to a favored few." [50]

(2) Proponents of the bill also argued that state and federal regulation of the utility industry could succeed only if the power and the scope of holding company influence were limited. Again, to quote from Roosevelt, "Regulation has small chance of ultimate success against the kind of concentrated wealth and economic power which holding companies have shown the ability to acquire in the utility field. No government effort can be expected to carry out effective, continuous, and intricate regulation of the kind of private empires within the Nation which the holding company device has proved capable of creating." [51] Dismemberment of the holding company structures and breaking them up into smaller units, the President argued, would make them more amenable to regulation.

(3) Nonintegrated holding companies were opposed on the ground that they served no demonstrably useful and necessary purpose. The proponents of the bill sought to realize and retain the operating economies which result from economically and geographically integrated public utility systems.

(4) The proponents also wished to raise the standards of corporate finance and management in the holding company field. To this end,

[50] *The Public Papers and Addresses of Franklin D. Roosevelt,* Vol. 4 (1938), p. 101.
[51] *Ibid.,* p. 100.

holding companies were to be subject to constant surveillance and regulation in all their activities. Such regulation, it was contended, would eradicate the abuses which had been disclosed by earlier investigation and prevent resort to predatory practices which had resulted in the exploitation of both consumers and small investors by holding company control groups.

Few pieces of legislation in recent years have been the focus of as intense controversy and debate as the Public Utility Holding Company Act of 1935. During the debate on the bill members of Congress were deluged with telegrams and letters from every section of the country intended to demonstrate that investors were solidly opposed to the bill. Further investigation revealed, however, that much of the supposed investor opposition was synthetic and manufactured by the holding companies themselves.[52] The President himself entered the fray in a message in which he sought to arouse investors against what he termed holding company propaganda. Stated the President, "I have watched the use of the investor's money to make the investor believe that the efforts of the government to protect him are designed to defraud him." [53] After a prolonged struggle, in the course of which some modifications were made in the original bill, the Holding Company Act was finally passed.

Briefly summarized, the scheme of the Act embodies six groups of regulatory provisions: (1) registration, Sections 4 and 5; (2) issuance of securities, Sections 6 and 7; (3) acquisitions of securities and utility assets, Sections 8, 9, and 10; (4) corporate simplification and reorganization, Section 11; (5) service, sales, and construction contracts and other intercompany transactions, Sections 12 and 13; and (6) reports and accounts, Sections 14 and 15.

Before proceeding to a more detailed analysis of the Act's provisions, certain general considerations perhaps ought to be stressed. In the first place, the standards of the Act are broad. Large discretion is vested in the Securities and Exchange Commission to take such action as it deems "necessary or appropriate in the public interest or for the protection of investors or consumers." There is considerable opportunity for flexible administration within the confines of the statutory mandate, far more, perhaps, than in most regulatory statutes. In the second place, the SEC is not in the fortunate position of start-

[52] See *Hearings*, Senate Special Committee to Investigate Lobbying Activities, S. Res. 165, 74th Cong., 1st Sess.

[53] *The Public Papers and Addresses of Franklin D. Roosevelt*, Vol. 4 (1938), p. 98.

ing out *tabula rasa* to design an ideal corporate structure for the utility industry. It inherits the existing structure with all its entrenched arrangements, expectations, and interests. While much of it may represent a hang-over from past improper financing and should, under the Act, be changed, it still remains true that it is not capable of fundamental modification at one fell swoop. Many of the readjustments will have to be molecular and interstitial rather than grandiose and spectacular. The Act itself in a sense recognizes this necessity. For, in addition to making provision for wholesale reorganization of capital and corporate structures and regrouping of physical properties, it also provides for less conspicuous day-to-day improvements in connection with the issuance of new securities, the improvement of accounting practices, the revamping of service arrangements, and the supervision of intercompany transactions. These gradual and detailed reforms in the standards of corporate finance and management need not, moreover, await a sweeping reorganization of the industry; in fact, if skillfully executed, they may help prepare and ease the way for such an eventual reorganization.

The first step in the regulatory process under the Holding Company Act is the registration requirement. Under the Act, all holding companies were required to register with the SEC before December 1, 1935, on pain of being forbidden to use the mails or engage in interstate commerce if they did not comply. Registration consisted of filing with the Commission a statement embodying information on corporate organization, structure, securities outstanding, balance sheets, income statements, and other similar data. Most of the major holding company systems defied this requirement and promptly brought suit to test the constitutionality of the Act in its entirety. Since none of the holding companies challenging the Act had registered, and since the other regulatory provisions of the Act applied only to registered companies, the government sought to confine its test case to the constitutionality of the registration provisions. In this maneuver it was successful.

The first important skirmish took place in the *Electric Bond and Share Company* case. A federal district court decision by Judge Mack in 1937 sustained the validity of Sections 4(a) and 5 and refused to discuss the constitutional merits of other portions of the Act. The holding companies concerned promptly filed an appeal, and eventually carried the case to the Supreme Court, which, in *Electric Bond*

and Share Co. v. *SEC*[54] (1938), sustained the lower court. The Supreme Court refused to accept the invitation of Electric Bond and Share and its associated companies to consider the constitutionality of the whole Act. "We are invited," said Chief Justice Hughes, "to enter into a speculative inquiry for the purpose of condemning statutory provisions the effect of which in concrete situations, not yet developed, cannot now be definitely perceived. We must decline that invitation. . . ." Meanwhile, after Judge Mack's decision in the district court, there had been a break in the ranks of the unregistered companies. Before the Supreme Court handed down its decision, holding companies representing 44 per cent of the assets of the industry had already filed notifications of registration. After the Court's decision the remaining holding companies followed suit, although, of course, reserving their right to raise other constitutional issues involved in the Act, as opportunity presented itself.

With registration effective, holding companies became subject to the remaining regulatory provisions of the Act. Of these, Section 11, the so-called "death sentence" clause, which provides for corporate simplification and reorganization, has attracted the greatest attention. Its provisions deserve careful analysis. Paragraph (a) Section 11, makes it the duty of the Commission to examine every holding company in order "to determine the extent to which the corporate structure of such holding company system and the companies therein may be simplified, unnecessary complexities therein eliminated, voting power fairly and equitably distributed among the holders of securities thereof, and the properties and business thereof confined to those necessary or appropriate to the operations of an integrated public utility system."

Under Section 11(b), it is made the duty of the Commission, as soon as practicable after January 1, 1938, to require every registered holding company, first, to limit its operation to a single integrated public utility system "and to such other businesses as are reasonably incidental, or economically necessary or appropriate to the operations of such integrated public utility system"; and, second, to "take such steps as the Commission shall find necessary to ensure that the corporate structure or continued existence of any company in the holding company system does not unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among

[54] 303 U.S. 419.

security holders, of such holding company system." Under the first or integration provisions, the Commission may, however, permit a registered holding company to continue to control one or more additional integrated public utility systems if it finds that:

> (A) Each of such additional systems cannot be operated as an independent system without the loss of substantial economies which can be secured by the retention of control by such holding company of such system;
> (B) All of such additional systems are located in one state, or in adjoining states, or in a contiguous foreign country; and
> (C) The continued combination of such systems under the control of such holding company is not so large (considering the state of the art and the area or region affected) as to impair the advantages of localized management, efficient operation, or the effectiveness of regulation.

Perhaps needless to say, these clauses bristle with difficulties. What is a "single integrated public utility system"? What businesses are "reasonably incidental, or economically necessary or appropriate to the operation of such integrated public utility systems"? When is a system "so large as to impair the advantages of localized management, efficient operation, or the effectiveness of regulation"? The Act itself sheds little light. We shall have to await administrative and perhaps judicial clarification.

The second or so-called antipyramiding provision also offers its problems. The statute states: "In carrying out the provisions of this paragraph the Commission shall require each registered holding company (and any company in the same holding company system with such holding company) to take such action as the Commission shall find necessary in order that such holding company shall cease to be a holding company with respect to each of its subsidiary companies which itself has a subsidiary company which is a holding company." Under the law, in other words, it is mandatory that there shall be no holding company beyond the second degree. The maximum limit in the way of complexity which the law permits is three tiers of companies—one, an operating company; two, a holding company controlling the operating company; and, three, a holding company over the first holding company. But it is important to note that the SEC is given power to require further simplification. The maximum degree of complexity is set by the Act; the minimum rests with the SEC.

In order to facilitate voluntary reorganization, the Act provides that any registered holding company may, after January 1, 1936, submit a plan of readjustment to the SEC for approval. If the Commission finds that such plan meets the provisions of Section 11(b) and is fair and equitable to the persons affected by such plan, the plan may be approved and put into effect. Under this provision of the Act, a number of voluntary plans have already been approved. The Commission has sought in every way to encourage voluntary action and, to a certain extent, its efforts have borne fruit.[55] It should, however, be emphasized that the problems presented by the companies which have utilized the machinery for voluntary compliance have been relatively simple.

It is the integration provisions of Section 11 which promise the greatest difficulty, and the real test of the efficacy of this section will probably not come until the SEC actually attempts to dismember nonintegrated holding companies. During the first four years after the passage of the Holding Company Act, the SEC proceeded cautiously. It invoked its mandatory power under Section 11(b) for the first time in 1937 in the *Utility Power and Light Company* case. That case, however, involved special circumstances. The company was undergoing reorganization under the Bankruptcy Act. In view of the nonintegrated character of the properties of the company, the Commission deemed it appropriate to intervene in the reorganization proceeding in order to make certain that the integration provisions of Section 11 would be met.

In dealing with other registered holding companies, the SEC moved more slowly. From the beginning it endeavored to obtain the benefit of industry views. The chief executives of these companies were invited by Chairman Douglas in 1938 to present not later than December 1, 1938, tentative suggestions and plans for compliance with Section 11(b). Suggestions were made by the major systems and studied by the staff of the Commission. Early in 1940 the Commission commenced proceedings under Section 11(b) with respect to the major holding company systems.[56] These proceedings were still in a preliminary stage early in 1941.

While the SEC's conciliatory policy, and its willingness to recognize that integration and simplification must be an essentially evolutionary process, have undoubtedly assuaged some of the bitterness of

[55] See *Sixth Annual Report of the SEC*, 1940, pp. 17–18.

[56] *Ibid.*, pp. 14–16.

utility opposition to the Holding Company Act, the real test is yet to come. Possibly adjustments can be made amicably and on a voluntary basis. Certainly it will be immeasurably more expeditious and easier to dismember nonintegrated holding company systems on a voluntary basis rather than by compulsion. The possibilities in this direction depend, in large measure, on the willingness of nonintegrated holding companies to work out their plans, deals, barters, and trades in accordance with the master plan of the Commission. Should the plans of the SEC and of the holding companies come into direct conflict, protracted litigation would appear to be inevitable. The Act provides that the Commission may apply to a court in order to enforce compliance with its 11(b) orders. The court in such cases is required to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee to hold and administer the assets of the company under the direction of the court. The trustee in such cases is required to execute the reorganization plan approved by the Commission. Should such drastic procedure be invoked, it seems highly likely that a host of legal problems will present themselves for settlement. Constitutional questions involving the right of the Commission to carry out its antipyramiding and integration programs, the power to compel the disposition or acquisition of particular properties in order to bring about desired integration, problems of the regulation of the terms of property transfers, questions of delegations of power, the validity of specific valuation determinations by the Commission, and similar questions, all furnish a fertile source for future litigation. Meanwhile, however, the wholesale reorganizations envisaged by Section 11 still remain to be realized.[57] Any appraisal of the "death sentence" clause must, therefore, await future action.

Meanwhile, however, important improvements in the standards of corporate finance and management appear to be taking place under other sections of the Act. Under Sections 6 and 7, which regulate the issuance of securities, and 8, 9, and 10, which regulate the acquisition of securities and utility assets, the Commission has endeavored to impose sound standards of public utility finance and management. It has discouraged the issue of securities which are unnecessarily risky and speculative and has sought to prevent the assumption of fixed charges beyond the limit of normal earning capacity. It has

[57] The problem of adjusting SEC plans with the Federal Power Commission's plans for interconnection and co-ordination presents further complications.

fostered the equitable distribution of voting power wherever possible and endeavored to ensure reasonable capital costs through the control of underwriting spreads and the elimination of conflicting interests in underwriting relationships. Through Section 11(g), in particular, the Commission is authorized to intervene in utility reorganizations, and its power has been exercised to require the disclosure of interests represented by parties submitting reorganization plans, to encourage independent representation of each class of security holders, to afford security holders full information as to how proposed plans affect their rights and interests, and to impose fiduciary responsibilities on persons soliciting proxies in connection with reorganization plans.

Under Sections 12 and 13, as has already been indicated, service, sales, and construction contracts, as well as other intercompany transactions, are for the first time brought under effective supervision.[58] Each registered holding company has been required to report information concerning all service, sales, and construction contracts in its registration statement. Section 13 of the Act thus fills another gap in public utility regulation. For the first time many state commissions are able to secure through the SEC information concerning service charges which were hitherto unavailable. The SEC has prescribed a uniform system of accounts and an annual report form for service companies which makes information available which should be of substantial assistance to state commissions in the solution of their rate problems.

In addition, the SEC has also prescribed a Uniform System of Accounts for Public Utility Holding Companies. This system is designed to render methods of accounting deception difficult, to

[58] As one representative of the Public Utilities Division of the Commission has pointed out:

"Under Section 13, the Commission has promulgated Rules setting forth the standards that subsidiary and mutual companies must meet. The same high standards apply to both types of companies. Those companies must meet certain prerequisites to Commission approval, such as—the services must benefit the companies receiving them; the services must be rendered at cost and that cost must be reasonable; the cost of services must be equitably allocated among the companies served; direct charges must be made as far as costs can be identified and related to specific transactions and indirect charges must be apportioned on an equitable basis; and the services must be economically and efficiently performed at a saving to the serviced companies."

(Nat. Assn. R.R. and Utilities Commissioners, Fiftieth Annual Convention, *Proceedings* (1939), p. 386.)

facilitate understanding on the part of investors, and to make information available to state regulatory commissions which should aid them in the performance of their duties. In this way, while the drastic provisions of Section 11 still remain largely in abeyance, changes in the standards and practices of holding companies are being introduced in piecemeal fashion, and their importance ought not to be overlooked. The Holding Company Act has been in effect for too short a period to permit realization of all its potentialities. It is possible at this time only to indicate general directions, and, because of the highly flexible standards of the Act, even general directions may be modified, given changed administrative leadership. At best, however, the SEC can only enforce high standards for the future; it cannot repair all the damages which unscrupulous holding company promoters have perpetrated in the past. The unfortunate victims of past excesses cannot look to the SEC for financial reparation; they can, however, look forward to protection from the Commission for such real interests as they retain in the reorganization of the industry which impends, and they may confidently look to the Act to prevent repetition of the abusive practices by which they were victimized.

7. Public Ownership and National Power Policy

Another significant aspect of New Deal power policy is revealed in the impetus given to public ownership in the power field. In the public mind, T.V.A. has come to symbolize this trend, but public power activities have by no means been confined to the Tennessee Valley. Vast water-power projects have also been initiated in other parts of the country. Bonneville and Grand Coulee in the Columbia River Valley, the Central Valley project in California, the power activities carried on under the aegis of the Lower Colorado River Authority, the Tri-county projects in Nebraska, Fort Peck Dam on the Missouri River in Montana, the Kendrick Project in Wyoming, the projected St. Lawrence River Development, and others bear witness to the rapid spread of large-scale hydroelectric developments. (See Table I.) Under the auspices of P.W.A., federal loans and grants have been made to local public bodies for the purpose of constructing their own generating or distribution facilities (see Table II); through the Rural Electrification Administration, loans have been made widely available to public bodies and co-operatives for the construc-

tion and operation of generating plants as well as electrical transmission or distribution lines or systems.[59]

TABLE I

FEDERAL POWER PROJECTS

Projects	Ultimate Generating Capacity: Kilowatts	Ultimate Cost	Initial Generating Capacity: Kilowatts	Allotment to June 1, 1939
Bonneville	434,250	$ 103,000,000	168,750	$ 81,720,700
Yakima-Roza	12,000	19,085,000	12,000	10,170,000
Grand Coulee	2,025,000	394,500,000	337,500	116,805,000
Central Valley	375,000	170,000,000	300,000	44,600,000
Fort Peck	401,250	122,900,000	71,860	110,877,000
Casper-Alcova (Kendrick)	33,750	20,000,000	22,500	18,182,000
Colorado–Big Thompson	142,500	43,749,000	30,000	4,600,000
Caballo–Elephant Butte	24,375	4,452,000	24,375	3,608,000
Denison	86,250	56,831,000	56,250	50,000,000
Marshall Ford	51,000	28,000,000	34,500	13,280,000
Bluestone	90,000	13,707,000	0	1,000,000
T.V.A.	1,909,500	589,640,000	726,600	320,069,270
Boulder Dam [60] and All-American Canal	1,381,500	170,000,000	909,000	151,810,000
Parker Dam	90,000	9,456,000	90,000	4,000,000
TOTAL—15 projects	7,056,375	$1,744,320,000	2,783,335	$930,721,970
Passamaquoddy	45,000	6,029,000	0	6,029,000
TOTAL—16 projects	7,101,375	$1,750,349,000	2,783,335	$936,750,970

The ultimate planned generating capacity of these projects, 7,101,375 kilowatts, represents approximately 18 per cent of the total installed capacity in the United States in 1938.

(Table from Ernest R. Abrams, *Power in Transition,* p. 25.)

[59] Up to May 1, 1939, the Rural Electrification Administration had made 592 allotments totaling $209,087,830, had completed and energized 99,657 miles of lines, and had provided services for 218,416 rural customers. (See *Congressional Record,* May 12, 1939, p. 7764.)

[60] Plans for the construction of Boulder Dam were laid long before the New Deal, and the contract for its construction was let in 1931.

TABLE II

PWA ALLOTMENTS TO NONFEDERAL PUBLIC POWER PROJECTS TO JUNE 1, 1939

Classification	*Number of Projects*	*Loans*	*Grants*	*Total Estimated Cost*
New Competitive Plants	100	$14,690,200	$20,093,744	$ 51,892,779
New Generating Plants for Existing Systems	18	486,500	1,221,707	2,888,035
Communities Previously Unserved	5	40,000	29,786	78,286
Street Lighting and Water Works	19	40,627	440,959	1,247,400
Large Power and District	19	78,328,700	51,181,768	168,523,527
Additions to Distribution Systems	97	273,975	4,714,583	12,716,875
Added Generating Capacity	113	1,084,000	14,963,935	35,991,874
Miscellaneous	42	29,729	500,435	1,241,712
Institutional	64	1,074,164	2,486,174	6,139,217
TOTAL	477	$96,047,895	$95,633,091	$280,719,705

(Table from Ernest R. Abrams, *Power in Transition,* p. 27.)

Behind the support and stimulus thus extended to public ownership lies a mixture of motives. While there has been little disposition to press for the socialization of the entire power industry, there was evident in the development of New Deal power policy a well-defined desire to preserve future water-power projects for public exploitation and development and to utilize public power projects as a device for regulating the privately owned sector of the power industry. At the root of this desire was considerable dissatisfaction with the results of the regulatory process as it has hitherto operated in the electrical utility field—a dissatisfaction which focused on high rates, low utilization, and limited availability of electricity. Through public competition or the threat of competition, the argument went, rates could be reduced and increased utilization stimulated. With the aid of public credit, electricity could be made available in rural areas, to potential consumers who had hitherto been without electricity. New public power projects, moreover, had an added attraction. To an administra-

tion intent on combating depression, power projects commended themselves as useful public works which could provide quick employment in a particularly depressed sector of the economy. In some cases, as in multipurpose projects of the T.V.A. variety, where the power aspects of the program were simply one phase of a broader program of regional planning and development, the very character of the undertaking seemed to make public sponsorship imperative.[61]

In singling out T.V.A. for discussion at greater length, we shall be dealing with a significant experiment in public ownership which exemplifies many of these motivating drives and which, from the beginning, has formed one of the storm centers of the New Deal's power policy.[62] The Tennessee Valley Authority Act, as approved on May 18, 1933, and amended August 31, 1935, marks an important milestone in the development of national power policy. In terms of the parties-in-interest analysis, the legislative mandate is clear. T.V.A. is directed to throw its weight on the side of the consumer—the potential as well as the actual consumer. The statement of policy in the Act is explicit:

. . . projects herein provided for shall be considered primarily as for the benefit of the people of the section as a whole and *particularly the domestic and rural consumers* to whom the power can economically be made available, and accordingly that sale to and use by industry shall be a secondary purpose, to be utilized principally to secure a sufficiently high

[61] In his message of April 10, 1933, recommending the creation of the Tennessee Valley Authority, President Roosevelt expressed its purposes as follows:

"It is clear that the Muscle Shoals development is but a small part of the potential public usefulness of the entire Tennessee River. Such use, if envisioned in its entirety, transcends mere power development; it enters the wide fields of flood control, soil erosion, afforestation, elimination from agricultural use of marginal lands, and distribution and diversification of industry. In short, this power development of war days leads logically to national planning for a complete river watershed involving many states and the future lives and welfare of millions. It touches and gives life to all forms of human concerns.

"I, therefore, suggest to the Congress legislation to create a Tennessee Valley Authority—a corporation clothed with the power of government but possessed of the flexibility and initiative of a private enterprise. It should be charged with the broadest duty of planning for the proper use, conservation, and development of the natural resources of the Tennessee River drainage basin and its adjoining territory for the general social and economic welfare of the Nation. This authority should also be clothed with the necessary power to carry these plans into effect. Its duty should be the rehabilitation of the Muscle Shoals development and the co-ordination of it with the wider plan."

[62] See Chapter 19 for further discussion of T.V.A.

load factor and revenue returns which will permit *domestic and rural use* at the lowest possible rates and in such manner as to encourage increased domestic and rural use of electricity. . . . [italics supplied]

T.V.A. has even wider implications. It is itself a venture in large-scale public ownership and operation and, under the terms of the Act, the Authority is, in effect, directed to encourage the spread of public ownership. Section 10 of the Act authorizes the Authority in selling surplus power, not used in its operations, to "give preference to states, counties, municipalities, and co-operative organizations of citizens or farmers, not organized or doing business for profit, but primarily for the purpose of supplying electricity to its own citizens or members. . . ." [63] Implicit in these statutory directions is the making of a new force in the determination of public policy—the welding together of a public power bloc composed of the T.V.A., its employees, and the network of communities which enjoys its benefits and falls within its sphere of influence. The Act thus builds up what might be called a vested interest in support of public ownership; it lays the basis for the emergence of a new party-in-interest in electricity, an organized and coherent body of public power exponents capable of mustering considerable political power to balance and counteract the influence of other parties-in-interest supporting the preservation of private ownership in the electrical utility field.

The T.V.A. Act has still another important aspect—its regulatory impact upon the conduct and policies of privately owned utilities in other parts of the country as well as in the T.V.A. area. The operations of T.V.A., it was felt, would invite comparisons with existing privately owned utilities; the very existence of T.V.A. and the fear

[63] Section 12a further provides:

"In order (1) to facilitate the disposition of the surplus power of the Corporation according to the policies set forth in this Act; (2) to give effect to the priority herein accorded to states, counties, municipalities, and nonprofit organizations in the purchase of such power by enabling them to acquire facilities for the distribution of such power; and (3) at the same time to preserve existing distribution facilities as going concerns and avoid duplication of such facilities, the board is authorized to advise and co-operate with and assist, by extending credit for a period not exceeding five years to states, counties, municipalities and nonprofit organizations situated within transmission distance from any dam where such power is generated by the Corporation in acquiring, improving, and operating (a) existing distribution facilities and incidental works, including generating plants; and (b) interconnecting transmission lines; or in acquiring any interest in such facilities, incidental works, and lines."

that the T.V.A. model might be imitated in other parts of the country promised to serve as a stimulant to privately owned companies to pursue rate and service policies calculated to dispel dissatisfaction with the results of private ownership. It was this regulatory potentiality that President Roosevelt had in mind in his address to the people of Tupelo, Mississippi, signers of the first contract for T.V.A. power, when he said, "I can use you as a text—a text that may be useful to many other parts of the nation, because people's eyes are upon you, and because what you are doing here is going to be copied in every state in the union before we get through." T.V.A. rates, added the President, would serve as a "yardstick" to measure the fairness of rates charged by private utilities and would help to reduce them where they were unreasonable.

In inaugurating its program, T.V.A. took over existing power facilities at Muscle Shoals, including hydroelectric generators at Wilson Dam and the adjacent Sheffield Steam Generating Plant. Part of the power thus generated was then being sold at wholesale to the Commonwealth and Southern system under a War Department contract which was to expire on December 31, 1933. The Tennessee Valley territory at the time of the passage of the Act was almost entirely served by privately owned utilities, of which companies belonging to the Commonwealth and Southern system formed a predominant part. With T.V.A. prepared to build new dams and generate additional power, the problem of the disposition of this power became important. The privately owned utilities in the region would, of course, have preferred to have T.V.A. sell them its power in bulk, leaving distribution and the fixing of retail rates in the hands of the private companies. But this T.V.A. was not prepared to do, and, in fact, could not do, under the terms of its Act. As has already been indicated, the policy of the Act directed T.V.A. to give preference to municipalities and farmers' co-operatives not operating for profit. Municipalities not owning their own electric systems and desiring T.V.A. power were faced with the choice of purchasing existing systems of the private companies or of constructing competing systems.

As the problem of adjusting relationships with the privately owned power companies in the area became urgent, negotiations were undertaken, and on January 4, 1934, a contract was signed with the Commonwealth and Southern Corporation and its subsidiary companies which embodied a division-of-territory arrangement. By the

provisions of this contract, T.V.A. agreed to purchase immediately all of the properties of the Mississippi Power Company in certain counties in northeastern Mississippi around Muscle Shoals. The Alabama Power Company, another Commonwealth and Southern subsidiary, also agreed to convey upon request certain properties in the northern Alabama area, near Muscle Shoals. These properties were intended to give T.V.A. an integrated territory in the vicinity of Wilson Dam. In addition, arrangements were made for the purchase of certain properties in eastern Tennessee from the Tennessee Electric Power Company.

These properties, together with the Knoxville properties which T.V.A. hoped to acquire from Electric Bond and Share, were expected to provide an integrated territory near Norris Dam, which was then under construction. The contract provided further that T.V.A. purchase certain municipal district systems in Mississippi; it also gave the Authority an option to purchase such systems in Tennessee with a provision that those not purchased by the Authority were to be sold to municipalities. The Alabama municipal district systems were to be sold to municipalities at fair prices. "Where no agreement as to prices to be paid by municipalities in Alabama and Tennessee for distribution systems could be reached in three months, the Authority was free to serve a competing plant, but the Authority agreed to endeavor to bring about the purchase of the existing systems by municipalities." Under the terms of the contract, the power companies "agreed not to serve areas transferred to the Authority or to municipalities," and the Authority agreed, with certain exceptions, not to serve outside the territory ceded to it "until . . . December 31, 1938, or until after the completion of the Norris Dam power plant, whichever is earlier." The contract also contained provisions for interchange of energy between T.V.A. and the power companies, an agreement by the Tennessee Electric Power Company to make domestic rate reductions, and an agreement on the part of the private power companies to co-operate with T.V.A. in promoting the sale of electric appliances. The chief significance of the agreement lay, however, in the division of territory provision. This arrangement was, of course, based to a considerable extent upon the limited capacity then available to T.V.A. at Wilson Dam, and, as has been indicated, it was to expire when additional power became available at Norris Dam.

The contract with Commonwealth and Southern, however, failed

to achieve its objective. The northeastern Mississippi properties were transferred to T.V.A. on June 1, 1934, but all efforts by T.V.A. to obtain conveyance of the Alabama and Tennessee properties proved fruitless. Negotiations by municipalities for the Alabama Power Company distribution systems were also unsuccessful. T.V.A. then endeavored to exercise its option to purchase these systems, but preferred stockholders of the Alabama Power Company challenged the legality of the transaction. This case—*Ashwander* v. *T.V.A.*[64]—was eventually carried to the Supreme Court, where, early in 1936, the validity of the January 4 contract was affirmed and the constitutionality of T.V.A., so far as it related to the authority to dispose of surplus electric power generated at Wilson Dam, was upheld.

Meanwhile, however, two years had passed, and the efforts of T.V.A. to obtain the properties of the Alabama Power Company were effectively frustrated. With the *Ashwander* case pending, all efforts of T.V.A. to obtain conveyance of properties in Tennessee also met rebuffs. The Tennessee Electric Power Company refused to convey the eastern Tennessee properties covered by the January 4 contract. Negotiations for the purchase of the Knoxville properties belonging to the Electric Bond and Share group also met failure. Though an agreement was reached and a contract signed and approved by the Tennessee Public Utilities Commission, suits brought by preferred stockholders held up the deal, and the consummation of the transaction was made impossible.

The immediate result from the point of view of T.V.A. was disastrous. The January 4 contract became a dead letter. T.V.A. found itself in a position where it could not acquire marketing outlets in the territory which was reserved to it under the contract, and it could not extend its marketing operation outside of this territory except to a very limited degree. This first effort to arrive at a voluntary division-of-territory arrangement wasted two years.

T.V.A., however, did not give up all hopes of co-operation. After the Supreme Court decision in the *Ashwander* case, negotiations were resumed with the private companies. Norris Dam was completed on August 3, 1936, and the contract of January 4, 1934, was to terminate ninety days thereafter. Under that contract, the Commonwealth and Southern companies purchased a substantial amount of T.V.A. power. Commonwealth and Southern needed the power, and T.V.A. could use the revenue. Consequently, negotiations were

[64] 297 U.S. 288.

opened with a view to reaching a new agreement. Wendell Willkie, on behalf of the Commonwealth and Southern companies, expressed a willingness to give up limited areas to T.V.A., including generating, transmission, and distribution facilities, provided that T.V.A. agreed to confine its operations to those areas and provided that Commonwealth and Southern were ensured against invasion of its reserved territory. As an alternative he offered to transfer all Commonwealth and Southern southeastern generating and transmission facilities to T.V.A., provided Commonwealth and Southern could retain the exclusive right to distribute T.V.A. power. Neither of these propositions was acceptable to the Authority. Instead, it suggested a plan for a southeastern power pool, which would include both public and private agencies, and which would offer a uniform pool gateway rate to all distributing systems, whether private or public. Under this plan, municipalities would have retained discretion to determine whether they preferred to own their own distributing facilities, and purchase T.V.A. power, or be served by privately owned companies. To this scheme Commonwealth and Southern objected on the ground that it gave them no protection against municipal competition and thus virtually shut off access to the capital markets for future refinancing.

Meanwhile, conferences continued, including a meeting at the White House on September 30, 1936. On October 7, 1936, T.V.A. and the Commonwealth and Southern companies agreed to a ninety-day extension of the January 4 contract to preserve the *status quo* while the possibilities of a "power pool" were being further explored. This "truce," however, came to an abrupt end when Commonwealth and Southern and its associated companies joined in an application for a temporary injunction in the case of *Tennessee Electric Power et al.* v. *T.V.A.* (the so-called 18 Power Companies case). On December 22, 1936, Judge Gore granted a sweeping injunction which, in effect, brought about the virtual suspension of all T.V.A. power activities. T.V.A. charged lack of good faith on the part of the power companies. The contract with Commonwealth and Southern was allowed to lapse and the power-pool negotiations were broken off.[65]

[65] On January 25, 1937, the President wrote Mr. Lilienthal:

"Since the conference of September 30, a sweeping preliminary injunction has been issued against the T.V.A. upon the application of 19 utility companies, including certain companies who were parties to the conference. The securing of an injunction of this broad character, under the circumstances, precludes a joint transmission facility arrangement, and makes it advisable to discontinue these conferences."

With the breakdown of negotiations with Commonwealth and Southern more aggressive marketing policies were pursued by T.V.A. A contract was negotiated with the Arkansas Power and Light Company to take the place of the contract with Commonwealth and Southern which had been allowed to lapse. New industrial contracts were also entered into with the Monsanto Chemical Company, the Victor Chemical Company, the Aluminum Company of America, and the Electro-Metallurgical Company. Applications from municipalities already served by private companies were welcomed, and a large number of the applicants, including Knoxville, Chattanooga, and Memphis, also applied for P.W.A. loans and grants to build competing distribution systems. Actual construction continued to be held up, however, until the Supreme Court passed on the legality of P.W.A. loans and grants.

Early in 1938, the Supreme Court in *Alabama Power Company* v. *Ickes* [66] affirmed the validity of P.W.A. loans and grants and ruled in effect that private companies were not immune from lawful competition. In the spring of the same year, a three-judge district court also rendered a decision favorable to T.V.A. in the 18 Power Companies case.[67] The P.W.A. decision, especially, had the effect of strengthening the bargaining position of T.V.A., since municipalities desiring T.V.A. power were now free to construct their own electrical systems. Negotiations were resumed with the private companies in order to prevent duplication, and a number of agreements were concluded. In June, 1938, the Electric Bond and Share Company sold the properties of the Tennessee Public Service Company, a subsidiary which operated in the Knoxville area. Other small companies belonging to the Electric Bond and Share group, including the West Tennessee Light and Power Company and an Associated Gas and Electric subsidiary, were acquired about the same time. The Supreme Court decision early in 1939 in the 18 Power Companies case,[68] which held, in effect, that the power companies operating in the T.V.A.'s territory had no standing in court to question the validity of T.V.A.'s power program or the constitutionality of the T.V.A. Act, served to reinforce T.V.A.'s bargaining position in pending negotiations with the Commonwealth and Southern group. Within

[66] 302 U.S. 464.

[67] *Tennessee Electric Power Co.* v. *T.V.A.*, 21 F. Supp. 947 (1938).

[68] 306 U.S. 118 (1939).

a week after the decision came the announcement of a tentative agreement by which T.V.A. and local public agencies were to acquire the Tennessee electrical properties of Commonwealth and Southern —including those located in Chattanooga and Nashville—for $78,600,000. This agreement was consummated August 15, 1939, and at the same time negotiations were also undertaken for the purchase of certain remaining Commonwealth and Southern properties in twenty-seven counties of Mississippi and Alabama. Meanwhile, on February 17, 1939, an agreement was announced by which T.V.A. and Memphis acquired the bulk of the property of the Memphis Power and Light Company, an Electric Bond and Share subsidiary.

With the completion of these transactions, T.V.A. approached the end of its program of acquisition of power facilities. After bitter and protracted negotiations, terms acceptable both to T.V.A. and the private power companies were found. One of the most controversial aspects of the T.V.A. power program—its relations with privately owned power companies in the region—thus became of purely historical interest. Competition taking the form of duplication of distributing facilities was largely avoided; negotiators representing T.V.A. and local municipalities revealed a willingness to make important concessions. In most cases, the prices paid by T.V.A. in its utility purchasing program enabled the privately owned companies to retire outstanding bonded indebtedness and preferred stock at par; they also provided some recognition for common stock or equity values.

With the completion of the utility purchasing program, T.V.A. is assured markets for all the power it can generate. Its marketing operations will embrace most of northern Alabama, northern Georgia, north and central Mississippi, a part of western North Carolina, and virtually the whole of Tennessee. Throughout this area public agencies will be responsible for the generation, transmission, and distribution of power. Under the Authority's original plan of development, a ten-dam system providing an ultimate installed capacity of 1,401,500 kilowatts was scheduled for completion in 1946–47. The pressure of the national defense emergency has forced an acceleration of this construction program; Congress in 1940 authorized a new steam-generating plant with an installed capacity of 120,000 kilowatts, a new dam (Cherokee Dam) in the Holston River with a planned capacity of 90,000 kilowatts, and the construction of new transmission facilities required on account of this added generating capacity.

SIGNIFICANCE OF T.V.A. AS A REGULATORY DEVICE

In many respects, it is still too early to assess T.V.A.'s power policy. Although the Authority has been in existence eight years, for the greater part of that period its power program has been held up by litigation; its construction program is still far from completion; and its marketing operations on a large scale have barely begun. Certainly judgments offered at this stage of the experiment must have a high degree of tentativeness.

No aspect of the T.V.A. experiment has aroused greater controversy than its significance as a regulatory device—its so-called "yardstick" function. The term "yardstick" is ambiguous; it lends itself to a variety of interpretations. T.V.A. is a venture in public ownership and operation under very special joint cost conditions. The problem of determining its economic profitability is complex and elusive, depending as it does on hypothetical assumptions involving controverted issues of allocation of costs as between electric power, navigation, and flood control, as well as differences of opinion on interest to be charged to investment and on calculations of depreciation and amortization. It is doubtful whether these issues can ever be resolved to the satisfaction of all the parties concerned in the T.V.A. controversy.

Clearly, if the objective be to test the general effectiveness of government ownership and operation as a method of producing and selling power, as compared with private ownership and operation, a study of T.V.A. operations alone can hardly establish a case for public ownership. Comparisons can be conclusive only where T.V.A. is compared with private enterprises operating under essentially similar conditions. With these difficulties in mind, the Engineering Staff of the Joint Congressional Committee Investigating the T.V.A. set forth the view that, on the assumption that the T.V.A. project when completed could be expected to cover its costs, "T.V.A. rates constitute a *legitimate, honest yardstick* of the accomplishments of a public agency under the operating conditions confronting the T.V.A."; [69] but they refused to go further. Indeed they repudiated any conception which implied the existence "of an absolute comparative yardstick to be applied any time, any place, and under any conditions to private industry." [70]

[69] S. Doc. 56, Part 3, 76th Cong., 1st Sess., p. 202.
[70] *Ibid.*

T.V.A. rates, however, are sometimes presented in a different aspect, as a measure of rates at which a well-managed and effectively regulated private enterprise should sell power. As the Report of the Joint Committee points out:

The yardstick is not in the Authority's wholesale rates, but in the retail rates of the various municipalities and other local organizations that have purchased Authority power and distributed it at unusually low rates. If their operations are shown to be of a kind that may be substantially duplicated in other parts of the country, their rates may be considered a Nation-wide yardstick, or measure of results to be expected. The yardstick is thus to be found in the operating records and results of the communities and co-operatives which are buying the Authority's power.[71]

This conception of the yardstick—that retail rates of T.V.A. distributors are a measure of the equitableness of rates charged by privately owned companies—has been vigorously assailed by spokesmen of the private power industry. They allege (1) that T.V.A. distributors receive a subsidy in the form of abnormally low wholesale rates; (2) that these local agencies also enjoy a concealed subsidy, in the form of free promotional services provided by T.V.A. which enable them to increase sales without cost; and (3) that the internal bookkeeping of these local agencies does not reflect the true costs assignable to their operations nor does it show costs that would be borne by private industry. To the first charge, T.V.A. spokesmen reply by pointing out that T.V.A. wholesale rates cover costs, that some private companies are selling large blocks of firm power at less than the Authority's wholesale rates, and that, in general, T.V.A. wholesale rates are approximately comparable to rates charged by private companies. To the second charge, T.V.A. spokesmen reply by pointing out that services provided by T.V.A. to local agencies are computed as costs covered by T.V.A.'s wholesale rates; they do not operate as hidden subsidies but are disclosed in T.V.A.'s accounts. To the third charge, T.V.A. replies, first, by pointing out that both municipalities and co-operatives keep their accounts in accordance with the uniform accounting system prescribed by the Federal Power Commission, which is also applicable to private companies, and that, in most cases, costs are covered, including the items of taxes so much stressed by the private utilities.

It is, perhaps, obvious that retail rates of T.V.A. distributors cannot

[71] S. Doc. 56, 76th Cong., 1st Sess., pp. 190–191.

be used as an *exact* measuring rod by which to judge the equitableness of private power rates. Costs of services vary legitimately in different parts of the country; market conditions show equal if not greater variability; any general comparison between T.V.A. rates and private power rates must necessarily be crude and subject to many qualifications on the score that unlike things are being compared. If the operating results of T.V.A. distributors have any general significance,[72] it is in their character as a demonstration project of a policy of market development in striking contrast with the marketing and pricing policies hitherto employed by most private utilities. As the Engineering Report of the T.V.A. Investigation points out:

> The traditional marketing approach of private industry has been to establish rates which will cover as far as it is possible to do so the entire costs of service immediately, and gradually to reduce rates over the long period of time required to develop the market under such rate policies; in other words, to make the rate-payer earn his rate reduction in advance.[73]

T.V.A., on the other hand, has deliberately embarked on a low rate policy "with a view to developing its markets rapidly";[74] it has arranged promotional rate schedules designed to encourage high utilization of electricity.

The striking results of this policy are indicated by a doubling of consumption among T.V.A. customers in the four-year period up to June 31, 1938, compared with an increase in the national consumption, during the four calendar years 1934–37, of 27 per cent.[75] During the same period the effect of T.V.A. promotional rate policies on rate

[72] In the fiscal year 1940, sixty-eight out of the seventy-four municipalities distributing T.V.A. power (including all those participating in the purchase of Commonwealth and Southern properties) reported net profits. Seventeen of the thirty-two rural co-operatives likewise reported net profits. Of the twenty-one municipal and co-operative undertakings suffering losses, all but four were still in the developmental stage. Aggregate net income for all distributors amounted to $4,023,000, after payment of operating expenses and amortization and interest charges. Operating expenses included taxes and tax equivalents amounting to $1,638,000 and provision for depreciation of $2,177,000. See Report from the Comptroller to the Directors of Tennessee Valley Authority on *Financial Statements of Municipalities (Electric Departments Only) and Co-operatives Purchasing Power from T.V.A.,* Fiscal Year Ending June 30, 1940.

[73] S. Doc. 56, Part 3, 76th Cong., 1st Sess., p. 201.

[74] *Ibid.*, p. 201.

[75] *Ibid.*, p. 208.

policies pursued by private utilities in the region affected by T.V.A. operations has been even more striking. Substantial rate reductions have been made by private utilities in the areas; the result has been a startling increase in average annual consumption per customer. The following table reveals the trend:

	1933		1937	
	Average rate	*Average kwh. per yr.*	*Average rate*	*Average kwh. per yr.*
Tenn. Electric Power Co.	5.77	612	2.86	1353
Georgia Power Co.	5.16	803	3.04	1313
Alabama Power Co.	4.62	793	2.97	1289
U.S. average	5.49	595	4.39	793

The threat of government competition has operated as a gadfly, compelling private utilities to emphasize efficiency and lower costs, to embark on promotional pricing and aggressive sales campaigns, to stress low rates and high utilization. Nor is there any indication that the profit margins of private power companies have suffered as the result of the adoption of new promotional rate schedules. In fact, the experience of Commonwealth and Southern subsidiaries in the area affected by T.V.A. would seem to indicate that profit margins may even increase under the stimulus of a low-rate, high-utilization policy.[76]

It is, of course, true that where government competition involves the actual construction of competitive generating, transmission, and distribution facilities, the result may be wasteful duplication of facilities. If considerable excess capacity is created, the result is likely to be inefficient conditions of operation for both private and public plants and serious losses for the public as well as for the private investor. If at some later stage private and public properties are merged, taxpayers and consumers may be compelled to shoulder at least part of the burden of excess investment. So far, however, these dangers have proved more theoretical than real. The problem of markets for the additional generating capacity made available by New Deal power projects has thus far not been a serious one. By and large, there are few instances where competitive distribution systems have

[76] See *Hearings of the Joint Committee investigating the Tennessee Valley Authority*, Vol. 1, p. 159.

been constructed and wasteful duplication of facilities has actually ensued. The most recent trend of New Deal power policy has emphasized "co-ordination of facilities" agreements between public power projects and private power interests, rather than aggressive competition and duplication of plant.

8. Summary

New Deal power policy has followed various directions. In part, as in the activities of the Federal Power Commission in the field of interstate transmission, it relies on the traditional technique of public utility regulation with all the problems of divided responsibility between regulatory agency and private management which that technique raises. In part, as in the holding company legislation, it is, in large measure, antitrust policy, though that aspect of New Deal power policy has not yet advanced far enough to permit any satisfactory judgment on its efficacy. Finally, New Deal power policy has involved the stimulation and extension of public ownership. To be sure, this policy, too, has not as yet gone very far. From 1932 to 1938 the percentage of total installed capacity in public ownership increased from 6.5 per cent to approximately only 10.7 per cent. Public ownership has been used chiefly as a threat and as a challenge to private utility management. Yet, in many respects, the threat of public competition of the T.V.A. variety has been the most potent and effective regulatory instrument which the national government has utilized in the electrical field.

A comparison of the equilibrium of forces in utility regulation today with the pre-1929 period discloses striking differences. Through agencies such as T.V.A., R.E.A., and P.W.A., whole communities and regions have been welded together into a public power bloc which forms a partially effective counterpoise to private utility interests. Financial control groups find themselves hedged about by restrictions; the small investor has found new protection in regulatory legislation. Consumer interests are far more articulately and effectively represented. The thrust of national power has left its mark.

Chapter Eleven. COMMUNICATIONS

1. Telephone and Telegraph Regulation

CORPORATE HISTORY AND INDUSTRIAL BACKGROUND

To understand the development of public policy in the field of wire communications, one must begin with the story of the commercial exploitation of the telegraph in the forties and fifties of the last century. In the telegraph industry a period of mushroom growth, characterized by the formation of numerous small companies in various parts of the United States, was followed by an era of consolidation. The Western Union Telegraph Company, which was organized in 1856, absorbed many of its smaller competitors and soon assumed a dominating position in the industry. The only effective challenge to its hegemony came when John W. Mackay decided in 1886 to enter the domestic telegraph field in order to provide a land outlet for his cable interests. The Postal Telegraph System, which was organized by the Mackay interests in 1886, absorbed various existing lines, built interconnections, and embarked on a new construction program which made it an effective competitor with Western Union on a continental scale. Two powerful combinations thus emerged as the dominant factors in wire telegraphy.

The commercial history of the telephone in the United States has become almost synonymous with the growth of the Bell System and its steady march toward integrated control of the entire telephone industry. The policies of that system and the techniques of defense and aggression which it utilized in consolidating its position and extending its sphere of control constitute a unique study in the politics of modern industry.

It is a story of humble beginnings. The commercial and financial world at first dismissed the telephone as merely an interesting scien-

tific toy. The strongly established Western Union interests were offered the Bell patents in 1876 for $100,000; they refused to buy. The realization of a missed opportunity came quickly; it was then too late to buy out the Bell interests, but not too late to enter into active competition with them. Armed with patents of its own, and mobilizing powerful financial support, Western Union sought to pre-empt the field. Patent litigation followed; but the Bell interests succeeded in attracting sufficient capital to protect their patents against legal attack and to enable them to embark on a policy of expansion. In 1879 a truce was concluded between Western Union and the Bell interests; Western Union recognized the priority of the Bell patents and agreed to retire from the telephone field. The Bell interests, in turn, agreed to keep out of the telegraph business and to compensate Western Union for its telephone ventures. With this treaty concluded, the most important obstacle to Bell expansion was removed.

The initial strength of the Bell interests lay in their patent position. As long as their patents remained valid, and financial support was available, there were few limits to Bell expansion. But the basic Bell patents were due to expire in 1893 and 1894. The strategy of entrenchment dictated plans to meet that contingency in order to ensure that Bell domination in the telephone industry would outlast the expiration of the patents. A variety of techniques was evolved to achieve this objective. License contracts were devised by which local operating companies granted a license to use Bell patents were required in exchange to turn over part of their stock to the parent Bell Company. Where stock interests acquired in this way were not sufficient to ensure Bell control, supplementary purchases of stock were made in the open market. Telephone apparatus was leased, but not sold. In order to control the manufacture and sale of telephone equipment, Western Electric was organized in 1882 as the manufacturing subsidiary of the Bell System. Until 1907 Western refused to sell apparatus to non-Bell companies. The Bell System also quickly expanded into the long-distance field. The construction of an elaborate network of long lines offered another obstacle to the development of competition on a regional or national basis.

These well-defined efforts to acquire and maintain control of the telephone industry beyond the span of the original patents met with resistance. Soon after the expiration of the patents, a large number of independent telephone companies were organized. The Bell interests fought strenuously to hinder the development of these independents.

Rate wars, efforts to prevent grants of franchises to competitors, refusals until 1907 to connect with certain independent companies, refusal to sell telephone instruments to non-Bell companies, purchase of control in so-called "opposition" companies, financial pressure brought to bear on independents to "sell out"—these and other devices were utilized to eliminate actual and potential competition. The last great effort to offer important competition to the Bell System took place in 1899, when the Telephone, Telegraph, and Cable Company was launched to act as a holding company to consolidate all independent telephone interests in the United States and to construct toll lines. When the financial backing of this company collapsed, the Bell System was left in command of the field.

The strategy of entrenchment in the telephone industry was now supplemented by the policy of expansion into adjacent communication fields. In 1909 the American Telephone and Telegraph Company (the Bell System) acquired control of Western Union by purchasing the stock of the Gould estate. But the resulting domination of the wire communications field evoked criticism. The Postal System complained that the Bell interests were using their telephone facilities to discriminate against Postal and in favor of Western Union. Independent telephone companies renewed their cries that the Bell System was refusing satisfactory long-distance connections and was seeking to eliminate the last vestiges of competition. At this point the government came into the picture. The threat to invoke the antitrust laws produced the so-called Kingsbury commitment (1913), by which A.T. & T. agreed to sell its holdings of Western Union stock, promised to desist from its policy of acquiring control of competing companies (acquisition of noncompeting companies was not mentioned), and agreed to connect its toll service system with the lines of independent companies where such companies met the physical equipment standards of the Bell System.

The Kingsbury commitment interposed obstacles to the acquisition of competing companies, but it did not put an end to them.[1] With the passage of the Willis-Graham Act in 1921, which permitted the

[1] "During the period of Government control, August 1, 1918, to July 31, 1919, all the telephone companies in the United States were operated under the control of the Postmaster General. They were subject to the direction of the operating board of the United States Telegraph and Telephone Administration and its subordinate personnel. The Postmaster General, in a statement of policy, indicated that Government operation and control of the telephone systems of the country would cause the co-ordination and consolidation of competing systems wherever possible; that such proposed con-

merger or consolidation of competing telephone companies subject to the approval of state authorities and the I.C.C., the Bell System again embarked upon a policy of active acquisition of independents. Some effort was made to allay the apprehension of independents. The Hall Memorandum which was issued in 1922 announced that the Bell policy was "not to purchase or consolidate with connecting or duplicating companies *except in special cases*"; the reservation proved sufficiently flexible to permit the purchase of such properties as the Bell System was anxious to acquire.

At the present time the Bell System control of desirable telephone exchange territory is substantially complete; it controls from 80 per cent to 90 per cent of local telephone service and 98 per cent of the long-distance telephone wires in the United States. Its manufacturing subsidiary, Western Electric, fabricates more than 90 per cent of the telephone equipment produced in this country.

At the same time the policy of expansion has been pursued with rare foresight. The acquisition of Western Union met a check in the form of the antitrust laws, but the Bell System's vast wire facilities continue to provide circuits for both Western Union and the Postal Telegraph companies. Bell control of important teletypewriter and telephoto patents has enabled it to take a commanding position in the provision of those services. Other patents give it a strong position in the field of sound recording and reproduction for motion pictures. The Bell interests were also quick to appreciate the importance of radio; the acquisition of important patents in the radio field has served to protect them from the potential encroachment of radio on wire telephony. The Bell System was among the pioneers in radio broadcasting. Although later forced to withdraw from this field, it continued to occupy a strategic position in broadcasting through the dependence of radio stations upon Bell System wire facilities. The concern of the Bell Company with television and the coaxial cable

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solidations would be submitted to the Post Office Department for approval. A committee was appointed to handle matters relating to consolidation. During this period there seems to have been a more strict adherence to the principles of the Kingsbury Commitment than existed either prior or subsequent thereto. In 1918, the Bell System purchased a total of 104,497 stations from and sold 111,759 to independents. In 1919, it purchased 56,937 stations and sold 70,225 stations. The years 1918 and 1919 are the only years during the period 1912–34, inclusive, in which the Bell System sold more stations than it purchased."

Federal Communications Commission, *Proposed Report, Telephone Investigation* (Pursuant to Pub. Res. No. 8, 74th Cong.), 1938, pp. 156–157.

evidences a continuing preoccupation with advances in the art of communication and an awareness of the high importance of staking out claims early, when significant advances in technology occur.

FEDERAL REGULATION OF WIRE COMMUNICATIONS PRIOR TO 1934

The policy of the national government toward wire communications began as one of aid and encouragement. In 1843 a Congressional appropriation was made available to construct an experimental telegraph line between Washington and Baltimore. Although this form of direct financial support was not continued, Congress, under the Post Roads Act (1866), provided construction rights to telegraph companies over the public domain, post roads, and navigable streams and waters of the United States. Under this act, the Postmaster General was authorized to fix special rates for government telegrams. Under a subsequent act passed in 1888 government-aided telegraph companies could be required by the I.C.C. to make connections wherever their lines met and to receive, deliver, and exchange business on equal terms.

General regulatory power over wire communication carriers was not vested in the I.C.C. until the passage of the Mann-Elkins Act in 1910. From the beginning this authority was of limited scope. The Act was not applicable to transmission "wholly within one state." The bulk of telephone communication was intrastate in character and could, therefore, be regulated only by state agencies. While telegraph communication was largely interstate, about 25 per cent of the total traffic was intrastate, and, therefore, also not subject to direct federal control.

Under the Mann-Elkins Act, the I.C.C. within its field of jurisdiction was given power to ensure that rates would be "just and reasonable," to eliminate discrimination and undue or unreasonable preferences, to undertake valuations, to prescribe uniform systems of accounts, and to require reports concerning the subject matter entrusted to it. The Act did not require communication companies to file their tariffs, nor could the Commission suspend rate changes pending an investigation of their reasonableness.

The I.C.C. made little attempt to use its power vigorously. In the twenty-four years that communication companies were subject to its jurisdiction, the Commission dealt with telegraph rates in eight cases, telephone rates in four cases, and cable rates in two cases. Few of these cases involved issues of major importance. The Commission

undertook no general rate investigation; it acted only on the basis of such complaints as were brought before it. The Commission never established a separate communications division; its regulatory responsibilities in the communications field were scattered among the various divisions dealing with railroad problems. The primary concern of the Commission was with railroads. In the absence of serious pressure to exert its power in the communications field, regulation went largely by default. The I.C.C. established uniform systems of accounts for telephone and telegraph carriers. It made valuation studies of the properties of certain wire telegraph companies. It required monthly and annual reports of financial and operating statistics. Under the Willis-Graham Act of 1921 it also exercised some authority over telephone consolidation. But, at best, it did little more than prepare the groundwork for more effective regulation.

STATE REGULATION OF WIRE COMMUNICATIONS

Meanwhile, the main burden of regulating the telephone industry fell upon the states, since the bulk of business was intrastate in character. In most states the established regulatory commissions were entrusted with jurisdiction over intrastate telephone rates and services. The technique of control followed the usual pattern of public utility regulation.

But state regulatory efforts in this field proved largely ineffective. Most state commissions simply were not equipped to cope with the complex problems posed by regulation of the telephone industry. The ordinary state public service commission was burdened with numerous other regulatory responsibilities besides supervision over telephone rates; it had to concern itself with electricity, gas, water, and other public utility enterprises. The average commission was inadequately staffed and financed. Consumer pressure to act vigorously in this field was at best sporadic and intermittent. In contrast with railroad rate controversies, where individual shippers may have substantial financial sums at stake, and shipper organizations exist to present the consumer's case, the stake of the individual telephone user is ordinarily very small. Except in unusual cases, users of telephone services are unlikely to carry the burden of a telephone rate case.

Furthermore, the public relations policies of the Bell System have been effectively developed to hinder any vigorous efforts at regulation. The Bell System has gross book assets of over $5,000,000,000; it

draws upon the support of over 700,000 investors; it employs in the neighborhood of 300,000 people; its influence is wide reaching and pervasive. As bank depositors, as buyers of materials, as dispensers of insurance contracts and other largess, the local Bell operating companies become intimately interwoven with the commercial structure of their communities and are able to draw upon powerful reservoirs of support which do much to discourage attacks on their rate structures.

The state commissions also face jurisdictional obstacles growing out of the Bell System's corporate organization. The commissions can function only within state boundaries; the Bell System is a national organization embracing more than two hundred corporations. At the apex of the Bell System is the A.T. & T. Company. It is both an operating company and a holding company. It functions as an operating company in the long-distance field through its Long Lines Department. As a holding company, it owns controlling securities in the Associated Bell Operating Companies. Some of these Associated Bell Operating Companies confine their activities to one state; others function in two or more states. As a holding company, A.T. & T. also dominates Western Electric, its manufacturing subsidiary; in addition, it controls a number of nontelephonic organizations.

Active managerial direction of the associated operating companies is centralized in A.T. & T., which is incorporated in New York. A.T. & T., of course, receives dividends on the stock which it holds in the operating companies. It also receives additional revenue from them through so-called license service contracts. Under the provisions of these contracts, A.T. & T. furnishes patent rights and other services to the operating companies; in exchange for these services the operating company pays a stipulated proportion of its gross earnings to A.T. & T. Since 1929 this proportion has been 1½ per cent. A.T. & T. also receives revenue through its control of Western Electric, which manufactures and sells telephone equipment to the operating companies and acts as the general purchasing agent of the System. The A.T. & T., in other words, siphons its earnings out of its subsidiaries through these various conduits. As former President Thayer of the A.T. & T. once said:

It does not matter particularly whether this money comes in the form of dividends, interest [on money advanced], 4½ per cent payments [the then current license contract fee], or profits on manufacture . . . the whole point is that in some way the revenue should come in so as to make the

earnings of not less than 10 per cent on the A.T. & T. company's stock. That way should be the way which is the least burden upon the public and the way which is the most satisfactory to the state commissions, but it is a matter that we cannot submit to the commission to decide. . . .[2]

State regulatory commissions have encountered tremendous difficulty in penetrating this corporate barricade. The organization of the Bell System presents formidable obstacles to the effective regulation of telephone rates. Under the prevailing system of rate regulation rates must be fixed so as to bring in sufficient revenue to cover reasonable operating expenses, including taxes and allowances for depreciation, and also to yield a fair return on a fair valuation of the property. The problem of determining fair value—and the corollary question of fair rate of return—are common to all public utility regulation and have already been discussed in connection with the regulation of electrical utilities. It is, perhaps, sufficient to note that no problem in the whole field of public utility regulation has given rise to more vexatious litigation than the problem of valuation. The telephone industry has been no exception.

Attention will be centered here on certain special problems which have proved peculiarly difficult in the telephone field, because of the organizational structure and practices of the Bell System. These include (1) the problem of license contract fees, (2) the problem of Western Electric prices, (3) the question of depreciation, and (4) the problem of separation of interstate and intrastate business.

LICENSE CONTRACT FEES

If rate regulation is to be effective, regulatory authorities must be armed with the power to pass on the reasonableness of operating expenses. Since roughly 80 cents out of every dollar paid by consumers of telephone service go to pay operating expenses, it can readily be seen how important it is that these costs be controlled. Among these costs are the "license contract fee" charged by A.T. & T. to its associated operating companies. How can the regulatory commission be certain that these fees bear a reasonable relation to the cost of the service furnished by A.T. & T.?

Until the Supreme Court's decision in *Smith* v. *Illinois Bell Telephone Company* [3] (1930), the A.T. & T. took the position that the

[2] F.C.C., *Proposed Report, Telephone Investigation* (1938), p. 681.
[3] 282 U.S. 133.

"costs incurred by it in rendering the alleged license contract services were immaterial to the validity of the contract fee as an operating expense." For many years the courts accepted this contention. In the *Smith* case, however, the Supreme Court for the first time required "specific findings by the statutory court with regard to the cost of these services to the American Company." Since that decision, A.T. & T. has presented cost studies in support of the license contract fee. But this has by no means disposed of the problem. The accounts of A.T. & T. have not been kept in such fashion as to show costs properly allocable to each license contract. Moreover, state commissions, because of their limited jurisdiction, have not had access to A.T. & T. records. As a result, most state commissions still lack the basic data which would enable them to pass on the reasonableness of license contract fees as an expense of the operating company.

WESTERN ELECTRIC COMPANY

Another problem peculiar to telephone regulation arises out of the special position of Western Electric in the Bell setup. Western Electric is, in effect, the Bell System's manufacturing department. It is wholly owned by A.T. & T. The Bell System operating companies are required to buy the overwhelming proportion of their apparatus and material from Western Electric. There is, of course, no arm's-length bargaining between them; both are controlled by A.T. & T., which ultimately controls the prices charged by Western Electric to the operating companies. These prices enter directly into the rate base of the operating companies, and, to a degree, into their operating expenses. If state commissions are to determine whether rates are reasonable, they must determine whether the prices charged by Western Electric are reasonable. It is, of course, difficult to pass on the reasonableness of these prices without knowledge of Western Electric costs. Here, again, state commissions run into a jurisdictional barrier. Without jurisdiction over Western Electric's operations, they have found it almost impossible to get any information as to Western Electric's true costs. In the absence of such knowledge, commission rate regulation has necessarily been regulation in the dark.

DEPRECIATION

The depreciation practices of the Bell System have also caused the state commissions considerable difficulty. It has been the policy of the

Bell Company to set aside substantial amounts annually to take care of depreciation. Over the years large amounts have been accumulated in the form of "depreciation reserves." At the end of 1936, these reserves amounted to $1,145,000,000, or approximately 28 per cent of the total Bell System investment in physical properties. Many regulatory commissions, following I.C.C. practice, have insisted that these depreciation reserves ought to be deducted from cost in determining the rate base upon which the Bell companies will be entitled to earn a fair return. The Bell companies, however, have taken the position that deduction for depreciation ought to be measured not by the size of the depreciation reserve, but by the amount of observed physical deterioration in the plant.

Since the depreciation reserve has usually been in excess of observed physical depreciation, the contention of the Bell System has been, in effect, a demand for a larger rate base upon which to compute the return to which it is entitled in the form of rates. The regulatory commissions have insisted that the depreciation practices of the Bell companies lead to an inflation of both operating expenses and the rate base. While the Supreme Court has yet to say that the reduction for depreciation in computing the rate base is measurable by the size of the depreciation reserve, it did point out, in *Lindheimer* v. *Illinois Bell Telephone Company* [4] (1934), that excessive annual allowances had been made for depreciation and that in such cases the depreciation reserve represented "provisions for capital additions, over and above the amount required to cover capital consumption." The *Lindheimer* case at least had the effect of inviting close scrutiny by the commissions of allowances for depreciation in order to prevent such allowances from being capitalized in the rate base. But the problem of determining accurate charges for depreciation remains a vexing one, and the controversy between the Bell companies and the state commissions as to the proper relationships of depreciation reserves with the rate base has yet to be finally settled.

SEPARATION

A further problem arising out of the widespread ramifications of the Bell System is the difficulty encountered by state commissions in segregating intrastate from interstate operations. Much of the Bell telephone plant is jointly used for both operations. A proper alloca-

[4] 291 U.S. 151.

tion of revenue and expenses between interstate and intrastate business is essential in view of the demands of our federal system; yet the problem is one of peculiar difficulty and intricacy, requiring data and accounting records which have not been hitherto available.

As a result of these complications, it is not unfair to say that telephone rate regulation by state commissions has been largely regulation by "guesswork." While some of the more powerful commissions have made diligent efforts to accumulate the data which would make efficient regulation possible, access to such data has been seriously impeded because the connecting corporate affiliates of the local operating companies have been outside the jurisdictional reach of the commission. The national character of the Bell System raises problems that cannot be solved by state action alone. The recognition that regulation could not hope to be successful unless jurisdiction was coextensive with the subject to be regulated led to the demand for an expansion of national regulation of the telephone industry. The Communications Act of 1934 was a partial answer to this demand.

THE FEDERAL COMMUNICATIONS COMMISSION

Soon after President Roosevelt took office, an Interdepartmental Committee was set up to study the communications situation and to make recommendations for new legislation. The decision to create a Federal Communications Commission grew out of its recommendations.

The Communications Act of 1934 is a broad regulatory measure embracing the whole field of communications—by radio as well as by wire. The Act creates a new Federal Communications Commission composed of seven members to whom are transferred all the duties, powers, and functions in the communications field formerly exercised by the I.C.C., the Postmaster General, and the Federal Radio Commission. (Title III of the Act embodies special provisions dealing with radio and will be discussed separately.)

The Act provides for a considerable amplification of federal authority in the field of wire communications. The Federal Communications Commission is vested with jurisdiction over interstate telephone and telegraph rates and services. The Commission is empowered to require that common carriers furnish adequate service upon reasonable request, to order physical connections with other carriers, to establish through routes and charges applicable thereto, and to arrange the divisions of such charges. It may issue or deny certificates

of public convenience and necessity for the construction or extension of lines, require filing and observance of schedules of charges, and investigate and suspend changes in charges. In general, these provisions of the Act are modeled on similar requirements in the field of railroad regulation.

The valuation section of the Act is largely an adaptation of the Railroad Valuation Act of 1913. The Commission is not required to make a valuation of the properties of communications companies as of any particular time, but may do so when necessary for the proper administration of the Act. The Act gives the Commission the power to require carriers to file inventories of their property, including estimated cost of reproduction new, reproduction cost new less depreciation, and original cost where available. The Act lays down no formula for valuation—it merely states that the Commission "shall be free to adopt any method of valuation which shall be lawful." The difficult problem of segregating interstate and intrastate property is met by a provision that the Commission may classify the property of telephone companies in order to determine what property of a carrier is used in interstate and foreign service and may, at its discretion, value that part of the property separately. This provision offers a hope of disposing of the difficult segregation problem which has plagued the state commissions.

The general policy of the Act appears to be to maintain competition in interstate and foreign communications. The jurisdiction over telephone consolidations formerly vested in the I.C.C. is transferred to the Commission. The Act makes it unlawful for any person to hold the position of officer or director of more than one carrier subject to the Act without the approval of the Commission. The combination of radio and wire communication companies is forbidden where the purpose or effect may be "substantially to lessen competition." The Act also grants the Commission power to require information in the form of reports, accounts, records, etc., from the companies subject to its jurisdiction. It may prescribe accounting forms and depreciation charges, inquire into the management of companies, and keep itself abreast of the advance of the arts "to the end that the benefits of new inventions may be made available to the people of the United States." While the Act gives the Commission no authority to pass on transactions between operating companies and affiliated companies involving supplies, research, services, finances, credit, or personnel, the Commission is instructed to in-

vestigate this field and to make recommendations for future legislation. Western Electric contracts, license fees, and other arrangements between the A.T. & T. and its subsidiaries are thus subject to investigation, and information revealed may be used to implement and strengthen both national and state regulation.

The Act also makes extensive provisions for co-operation with state commissions. Such co-operation is particularly important in the field of telephone regulation, since under the Act a preponderant part of telephone regulation remains intrastate and is subject to exclusive state regulation. Provision is made, however, for co-operation between federal and state authorities in order to facilitate the proposed segregation of interstate and intrastate property, and to avoid conflicts between federal and state accounting and other requirements. The Act provides for joint boards on which the F.C.C. and state agencies may be represented, and for joint hearings with any state commission in connection with any matter with respect to which the Commission is authorized to act. The provisions for reciprocal co-operation with state commissions are of great importance, since the development of adequate machinery to implement such co-operation is essential to effective regulation.

REGULATION OF THE TELEGRAPH INDUSTRY

The basic problem of the telegraph industry is the problem of an industry in decline. Western Union, after a long and enviable earning record, began to show substantial losses in the late thirties, although the earning record for 1940 was considerably improved. Postal Telegraph's financial position has been far more precarious, and early in 1941 that company was still in process of reorganization under Section 77B of the Bankruptcy Act. Destructive competition within the telegraph industry itself, the diversion of traffic to other forms of communication, including long-distance telephone, teletypewriter, air mail, and domestic radio services, the competition offered by the government through its army and navy telegraph system, and higher costs of operation in recent years have all contributed to the plight of the industry.

The policy of the Communications Act of 1934 is to encourage competition in the telegraph field. Because of doubts as to the wisdom of this basic policy, the Federal Communications Commission recommended in 1935 that legislation be enacted enabling it to approve and authorize consolidation of telegraph companies. The Commis-

sion also recommended that it be given power to afford protection to employees who may be dismissed as the result of consolidation, and that it be vested with strengthened authority over the service, rates, and capitalization of the affected companies. No action was taken on this recommendation.

As the financial plight of the telegraph companies became more desperate, interest in consolidation was revived. On June 19, 1939, the Senate authorized an investigation of the telegraph industry, and a subcommittee of the Interstate Commerce Committee, headed by Senator Burton K. Wheeler, was directed to conduct the study. The scope of the investigation as outlined by Senator Wheeler embraces issues of tremendous importance:

> Can the present companies under proper supervision profitably continue and prosper? Should the landline telegraph systems be consolidated? Should the landline and the international systems be consolidated? Should the landline, international, and telephone systems be consolidated into one gigantic monopoly? Should each of the three types of communication —written, oral, and radio—be confined to prescribed limits of activity?
>
> What effect would each of these have upon employment? Upon the efficiency of the services rendered? And how will the public interest be best served? [5]

Early in 1941 these momentous questions were still being studied; the Committee had yet to report its recommendations.[6]

TELEPHONE REGULATION

The Federal Communications Commission began its duties in the telephone field by setting up a special Telephone Division inside the Commission.[7] The initial work of that division was of a routine organizational character, involving the classification of carriers, the filing of tariffs, the preparation of a system of accounts, etc. The Commission encountered resistance at the threshold of its activity.

[5] See *Hearings,* Subcommittee of Senate Committee on Interstate Commerce on S. Res. 95, 76th Cong., 1st Sess., 1939, p. 2.

[6] On January 3, 1940, the Federal Communications Commission renewed its recommendations that Congress enact legislation to remove the existing prohibition against telegraph consolidation. See *Report on the Telegraph Industry,* filed by Chairman J. L. Fly with the Senate Subcommittee designated to investigate conditions in the telegraph industry pursuant to S. Res. 95, 76th Cong., 1st Sess.

[7] By Commission order, effective November 15, 1937, the divisional organization of the Commission into Telephone, Telegraph, and Radio Divisions was abolished.

The proposed uniform system of accounts was challenged by the Bell System in the courts, chiefly because of the requirement that the accounts of the telephone companies show the original cost of their property. On appeal, however, the Supreme Court, speaking through Justice Cardozo, upheld the Commission.[8]

It became clear at the outset that very little information was available on interstate telephone operations, and that one of the first tasks which faced the Commission was to find out about the telephone business. In March, 1935, Congress authorized the Commission to conduct a comprehensive investigation, for which $1,500,000 was ultimately appropriated. The Commission was instructed, among other things, to investigate the capital structure of the Bell System, its intercompany relationships, its license service contracts, its accounting methods, its depreciation practices, its patent policies, its methods of competition, its public relations activities, its toll operations, Western Electric costs and prices, and other aspects of the business which bear on the problem of regulation. After an elaborate investigation,[9] Commissioner Walker, who was in charge of the investigation, submitted a Proposed Report to the Commission

[8] *A.T. & T.* v. *United States,* 299 U.S. 232 (1936).

[9] The record of the investigation is massive. It contains 8,441 printed pages of testimony, 2,140 exhibits, and 77 formal staff reports on various phases of the Bell System. The investigation has been criticized by Bell representatives as an unfair ex parte proceeding. The only witnesses who testified were those summoned by the Commission. Counsel for the Bell System were not permitted to cross-examine witnesses or present witnesses of their own. "At the close of the hearings it was announced that the American Telephone and Telegraph Co. would be permitted to submit statements in writing pointing out any inaccuracies in factual data or statistics in the reports introduced in the hearings or in any testimony in connection therewith, provided that such statements were confined to the presentation of facts and that no attempts would be made therein to draw conclusions therefrom." The A.T. & T. replied by filing approximately fifty volumes of "comment" on the investigation. These "comments" the F.C.C. refused to incorporate in the record of the investigation on the ground that "they contained much argumentative material and unsupported assertions in addition to corrections of factual or statistical data." The Commission reports, however, that "these comments were . . . considered, in so far as they related to corrections of factual or statistical data." After the submission of Commissioner Walker's Proposed Report on the Telephone Investigation in February, 1938, "the Commission authorized the filing of a brief by the Bell System Cos. and also oral argument on the proposed report, if desired. A brief was filed, but the companies did not avail themselves of the opportunity for oral argument." See Introduction, *Report of the F.C.C. on the Investigation of the Telephone Industry in the United States,* made pursuant to Public Resolution No. 8, 74th Congress, H. Doc. 340, 76th Cong., 1st Sess. (1939), pp. XVIII–XIX.

on February 23, 1938, which contained a number of specific recommendations. These recommendations were of two kinds: (1) measures which could be taken by the Commission in the exercise of its present jurisdiction and authority, and (2) proposals to add to the authority of the Commission in order to secure more effective regulation.

In the first category were recommendations for the reform of depreciation practices, pension policies, and public relations activities of the Bell System. The Report suggested that annual depreciation charges should be as nearly equal as may be to the depreciation currently accruing to the property, that accumulated depreciation reserves be held as trust funds for the benefit of subscribers, and that the full depreciation reserve be deducted from cost in determining the rate base. Among the important reforms suggested in the Bell pension plan are the abrogation of the right to revoke or suspend benefits earned under the terms of the plan and drastic reductions in large pensions payable to executives. With respect to public relations, the Report recommended that expenses incurred for dues to civic, commercial, professional, and social groups, and for charitable organizations, should not be chargeable to operating expenses; that concessions or free service be prohibited; and that legislative agents of the Company be required to register.

The Report further suggested that Congress add to the authority of the F.C.C. by giving it considerable additional powers. These would include the powers:

(1) to review, approve, or disapprove all Bell System policies and practices promulgated by the central management group of A.T. & T.

(2) to regulate the costs and prices of telephone apparatus and equipment.

(3) to review, approve, or disapprove all intercompany contracts.

(4) to regulate Bell System financing including (a) the power to require competitive bidding in the issuance of securities; (b) the power to determine conditions under which future issues of capital stock shall be authorized; (c) the power to regulate the conditions of loans and the costs of funds advanced by the A.T. & T. to the associated companies; and (d) the power to regulate the acquisition of securities in subsidiary telephone companies, whether for purposes of financing or for extension of control.

(5) to limit the scope of Bell System activities to the communica-

tions field and to permit the Bell System or any utility engaged in interstate communications to obtain, subject to Commission determination, the right to use patents owned by others, which may be essential to the rendition of communications service to the public. The Commission would be authorized to order the issuance of licenses in the event that the Bell System, or any utility engaged in interstate communications, refused to license its patents on reasonable terms.

In addition, the Walker Report called for clarification of the powers of the Commission with respect to consolidations and acquisition of securities, authority over abandonments and entrance into territory already served, and divisions of charges on joint interstate rates. The Report also recommended that the Commission be given power to prescribe temporary rates, and that there be a specific legislative declaration that prudent investment be used as the rate base. Discrimination with respect to the use of wires in chain broadcasting or in radio communication of any kind was to be prohibited. The Commission was also to be empowered to deal with problems occasioned by the circulation of racing and other sporting news through leased wire or other telephone facilities or service. The Report recommended, finally, that adequate funds be provided to continue the work of the Rate and Research Department of the investigation, and that a law be enacted assessing the costs of regulation against the industry.

These recommendations were transmitted to Congress without having been acted upon by the whole Commission. The official Commission report was not submitted until June 13, 1939, and it was considerably less sweeping and far reaching in its recommendations. The report made nine specific recommendations looking to stricter regulation of the industry: [10]

First, specifically to authorize this Commission to prescribe basic cost-accounting methods to be followed by manufacturing companies under contract with operating telephone companies for the general supplying of materials or equipment, and by manufacturing companies subsidiary to or affiliated with operating telephone companies through corporate structure.

Second, to require approval by this Commission for, and as a condition precedent to, the issuance or refunding of any securities of corpora-

[10] *Report of the F.C.C. on the Investigation of the Telephone Industry in the United States,* made pursuant to Public Resolution No. 8, 74th Congress (1939), p. 601.

tions which offer telephone service subject to this Commission's jurisdiction.

Third, amend section 201 (a) of the Communications Act to clarify this Commission's jurisdiction over the division of joint interstate rates per se. As the section stands it might be contended that the jurisdiction of the Commission is limited in this connection to those instances wherein a physical connection has been ordered by the Commission.

Fourth, amend section 202 (b) so as to make it clear by specific language rather than by implication that practices, classifications, regulations, and facilities, as well as services and charges, in connection with the use of wires in chain broadcasting shall be subject to regulation by this Commission and so that this section of the act will correspond to the preceding half of the section, 202 (a).

Fifth, amend section 214 (a) of the act to prohibit the abandonment of any interstate line operated by any carrier subject to the act without authorization from this Commission.

Sixth, amend section 221 (a) so as to make the application for consolidations of telephone companies subject to the act mandatory.

Seventh, amend section 221 (a) so as to require approval by the Commission of all acquisitions by one company of the stock or voting stock of another company for purposes of control.

Eighth, in the event of the refusal of any common-carrier utility engaged in interstate communications to license others upon reasonable terms under any patents obtained in connection with communication service to the general public as a common-carrier utility, the Commission should be empowered, upon the application of parties so refused, to order the issuance of such license; provided that the granting thereof will not be detrimental to the communication service rendered by the utility holding such patents and not detrimental to technical progress.

Ninth, it is suggested that the Congress give consideration to the question of assessing the cost of regulation against the industry to be regulated.

Up to early 1941, none of these recommendations had yet been acted upon by the Congress. That does not mean, however, that the Telephone Investigation has been without effect. "During the course of the investigation, and as a result of the direct efforts of the investigatory staff," the Commission points out, "telephone-rate reductions now aggregating in excess of $30,000,000 were effected in the interest and for the benefit of the American telephone-using public." [11] At the same time, the Telephone Investigation has proved

[11] *Ibid.*, p. 602.

of considerable aid in helping state commissions to secure rate adjustments.[12] The basic data gathered by the investigation have been made freely available to the state commissions and have helped to strengthen co-operative working relationships between the F.C.C. and various state regulatory agencies. Whether these relationships can be improved and perfected will depend on whether staffs and funds are provided to ensure continuity in investigation and supervision in the future.

2. Radio Regulation

In no field, perhaps, is the technical imperative for government to regulate more immediate and direct than in radio. The number of radio channels is limited. The number of persons desiring to broadcast is far greater than can be accommodated on the air. Unless some scheme of effective central control is established by which channels are allocated and radio stations are confined to a definite place on the radio spectrum, the practical application of radio becomes impossible. In view of the emphasis that will be placed here on the regulatory problems arising out of radio broadcasting, it is worth noting that broadcasting is only one of many radio uses. Regulatory authorities are also faced with the problem of finding a place on the radio spectrum for ship-to-shore radio services, for aviation and police purposes, for commercial radio telephone communications, for press dispatches, for amateurs, for scientific research, for television, and for a variety of other special needs. Regulatory authorities are not only faced with the problem of adjusting the claims of rival broadcasters; they must also mediate between radio broadcasting and alternative radio uses.

Radio regulation, like regulation in many other fields, came after, and not before, the art was already well advanced and its commercial exploitation was well under way. Prior to the crystallization of regulatory policy, an industry had already grown up, strategic positions had

[12] As an illustration, the Commission points to the results of the publication of its Hand Telephone Set Report. "Prior to the publication of the Hand Telephone Set Report, the added charge for such service was made in every state and the District of Columbia. On January 1, 1938, approximately one year after the publication of the Hand Telephone Set Report, the added charge had been entirely eliminated in eighteen states and the District of Columbia, and provision for its elimination within one to twenty-four months had been made in twenty-six other states. In many of these twenty-six states the amount of the added charge was reduced during 1937."

been occupied, vested interests were established, and the basic characteristics of the American system of broadcasting had already manifested themselves. Some familiarity with this background is indispensable to an understanding of the pattern of regulation which emerged.

PATENT CONTROL AND THE RADIO INDUSTRY

In the initial stages of development of the radio industry, control of patents was a strategic factor in the struggle for domination. To begin with, the important patents were controlled by the Marconi interests. The first radio company in the United States, the Marconi Wireless and Telegraph Company which was organized in 1899, principally to supply radio service to ships, was owned and controlled by the British Marconi Company. As the potentialities of radio began to be appreciated, a number of American inventors turned their talents in that direction and made important discoveries. Out of these discoveries there arose a number of basic patent claims, many of which were controlled by scattered interests, some of which involved possible infringement on pre-existing patents, and most of which could not be efficiently used except in conjunction with apparatus controlled by other patentees. As the commercial possibilities of radio became clear, a number of American companies, including General Electric, Westinghouse, and A.T. & T., sponsored programs of research in order to gain possession of radio patent rights and to establish priority in the field. The result was a considerable dispersion of patent control, charges of patent infringement, and threats of litigation.

In the struggle for position, the General Electric Company gained an initial advantage.[13] After the first World War, the Radio Cor-

[13] During the first World War, the United States government took over control of all radio-communications facilities, including the American Marconi Company. Since the government was interested in securing the most efficient radio apparatus available, it cut through the patent tangle and assumed responsibility for such patent infringement suits as might develop. The result was the most successful radio transmitting and receiving apparatus developed up to that time. At the same time, the war experience called attention to the fact that in a number of cases international radio communications from the United States had fallen into the hands of foreign radio companies. After the war, the Navy Department expressed the hope that radio communications in the United States would be retained under American control and that an American Company could be formed to achieve this purpose. The General Electric Company seized the initiative at this point. Aided by pressure from the government, the Marconi Company was persuaded to sell out to General Electric.

poration of America (RCA), which was organized by General Electric, acquired the assets and patent rights of the Marconi Company, as well as all rights under radio patents owned by General Electric. RCA agreed to purchase all of its radio equipment from General Electric. This development aroused immediate reactions from Westinghouse and A.T. & T. Patent infringement suits were threatened, and the settlement of the many conflicting claims promised prolonged strife and litigation. The conflict which threatened was temporarily adjusted by a series of cross-licensing agreements in 1920–21, as a result of which RCA and General Electric, Westinghouse, A.T. & T., and several smaller companies agreed to give each other the use in certain fields of patents and patent rights owned by the other parties. Among other things, Westinghouse acquired a stock interest in RCA, and RCA agreed to divide the purchase of radio equipment between Westinghouse and General Electric. As a result of the community of interest thus established, RCA, Westinghouse, and General Electric became known as the Radio group. Disagreement soon developed as to the rights acquired under the 1920 agreement by A.T. & T., on the one hand, and RCA and other members of the Radio group on the other. Meanwhile, A.T. & T. continued its aggressive expansion in the broadcasting field. It established and operated several stations and sought to use its control over wire facilities essential to broadcasting in order to secure a foothold in this new field. Further conflict was finally averted, however, when RCA and the Bell System concluded a new treaty of peace in 1926. As a result of this agreement, the Bell System sold its radio broadcasting interests to RCA. In exchange, its firm grip upon the furnishing of wire facilities for broadcasting was reinforced and its hold on two-way radio telephone commercial service was strengthened.

The result of this agreement was to centralize control of most of the basic radio patents in the hands of RCA and its cross-licensing associates. Manufacturers in the radio field who were not parties to the cross-licensing agreement operated under a form of licensing arrangement which required them to pay specified royalties to the RCA patent pool. By May, 1930, 95 per cent of the value of all radio-receiving apparatus was manufactured by licensees of the RCA patent pool. In that month the Department of Justice brought suit against the parties to the cross-licensing agreement on the ground that these agreements violated the antitrust laws by restricting competition between members of the pool as well as between them and their rivals.

Following this suit a consent decree was entered November 21, 1932, by which General Electric and Westinghouse agreed to divest themselves of their holdings of RCA stock, and pooled patents were made available to all manufacturers of radio equipment on equal terms. As a result of this consent decree, RCA continues to receive royalties; but instead of acting simply as a selling agency for Westinghouse and General Electric equipment, it now manufactures its own radio sets, which it sells in competition with other sets manufactured by its licensees.

THE BEGINNINGS OF BROADCASTING AND PUBLIC REGULATION

The first public broadcasting service was inaugurated by the Westinghouse station in Pittsburgh, KDKA, on November 2, 1920, when the returns of the Presidential election were announced. The instant success of this station's operations led Westinghouse to erect more stations. The public received radio with enthusiasm; manufacturers of receiving sets for a time could hardly cope with the demand. General Electric and A.T. & T. quickly followed Westinghouse into the broadcasting field. In addition, a host of smaller companies erected stations. Some were established by commercial interests to build good will; others, to obtain advertising revenue. Some stations were also established by churches, colleges, and other noncommercial institutions.

Prior to 1927, broadcasting presented the chaos of a new industry, its vitality outrunning the bounds of public control. In the first burst of expansion of radio between 1920 and 1927, the only important law capable of being applied to regulate broadcasting was an Act of 1912, which was really intended to regulate radiotelephony. This Act established the Secretary of Commerce as the licensing authority for all forms of radio communications. Under the Act, operation without a license was punishable as a misdemeanor, and the apparatus was subject to forfeiture. Soon after the passage of this Act, the question arose as to whether the Secretary could exercise any discretion in the issuance of licenses or whether he was under the mandatory duty of granting licenses to all applicants. The Secretary requested an opinion from the Attorney General. The Attorney General replied that no discretion was vested in the Secretary to refuse a license.

Under this theory of the Act, the ether appeared to be available to all comers, regardless of whether they could or could not be accommodated without causing intolerable interference. As broad-

casting passed into its stage of rapid and extraordinary growth, it became increasingly evident that the Act of 1912 was inadequate to cope with the problem. The Secretary of Commerce sought to deal with it by asserting discretion to refuse a license where technical factors of interference made it seem necessary. In *Hoover* v. *Intercity Radio Co.*,[14] February 5, 1923, the Court of Appeals of the District of Columbia, though reiterating that the issuance of a license was a mandatory act, declared that under the Act the Secretary of Commerce might designate the wave length upon which the licensee was to operate. Aided by this hint, the Secretary called a conference of broadcasting and other interested parties, the result of which was the allocation of frequencies in the "broadcast band," 500 to 1500 kilocycles.

But the demand for frequencies far exceeded the supply. As applications for broadcasting licenses continued to roll in, and dissatisfaction with allocations developed, a test of the legal powers of the Secretary became inevitable. In 1926, a Chicago station, dissatisfied with its assigned frequency and hours of operation, "jumped" its wave length and operated at hours not permitted by its license. The Secretary of Commerce brought suit to invoke the penalties provided in the Act for operation not "in accordance with a license." In *United States* v. *Zenith Radio Corporation* (1926), Judge Wilkerson decided the case in favor of the company. The Secretary then requested the Attorney General for an opinion as to his powers and duties with respect to regulation of radio broadcasting under the Act of 1912. That opinion, which was rendered July 8, 1926, held that the Secretary of Commerce had no discretion to refuse a license upon proper application, that he had no power to designate the frequency on which a broadcasting station must operate, that stations were free to select other wave lengths for operation, that the Secretary had no power to prescribe hours of operation, and that he could not limit the power of stations nor issue licenses of limited duration. The Secretary thereafter ceased to assign frequencies; stations used whatever frequencies they chose. A mad scramble ensued for favorable wave lengths and greater power. The result was pandemonium on the air. Broadcasting was in danger of being thoroughly discredited. The industry now joined with the listening public in demands that something be done to "clear the air." With this widespread demand for

[14] 286 F. 1003.

action, the way was at last prepared for some more thoroughgoing scheme of radio control.

By the time Congress was prepared to lay down the basic statute for radio regulation, the broadcasting industry in the United States had already largely taken shape. The basic principle was established that broadcasting was available for commercial exploitation by private capital. The policy of selling "time on the air" and using advertising as a means of financing broadcasting was already firmly established. By 1926, the first national network, the National Broadcasting Company (NBC), had been organized by RCA, General Electric, and Westinghouse—all pioneers in the broadcasting field. Other chains loomed on the horizon. Broadcasting was becoming big business with substantial investments at stake. Prevailing views of the proper scope of governmental action, moreover, were antagonistic to public occupation of the field. While it was recognized that regulation of radio frequencies was necessary to avoid bedlam, the dominant political philosophy dictated a minimum of interference with business enterprise.

THE RADIO ACT OF 1927 AND THE FEDERAL RADIO COMMISSION

The Radio Act of 1927 bore the marks of compromise from the start. The administration of the law was placed in the hands of a newly organized Federal Radio Commission, composed of five members, to be appointed by the President with the consent of the Senate. Originally the Commission was created for one year only; divergent views in the two Houses of Congress as to whether the Secretary of Commerce or a new Commission should regulate radio communications dictated the establishment of the latter on a temporary basis. In issuing new licenses the Commission was given definite authority to assign wave lengths and fix power output and time of operation. The Act, however, limited the time for which a license might be issued to a maximum of three years for a broadcasting station and five for any other class of station. The term of the license could be further limited by Commission action. Broadcasting licenses were first issued for a three-month period; the period was later increased to six months. At the present time the term of the license is one year. The Act also specified that licensees were to enjoy no vested rights in the ether. Station construction or additions could not be undertaken without the consent of the Commission. Such consent was also necessary to legalize transfers of license ownership.

The Act of 1927 introduced the standard of "public interest" as a guide to the exercise of discretion by the licensing authority. Grants, renewals, and modifications of licenses were made conditional on a finding by the licensing authority that "public interest, convenience, or necessity" would be served thereby. In allocating broadcasting facilities, the Commission was instructed to make such a distribution of facilities "among the different States and communities as to give fair, efficient, and equitable radio service to each of same." To help make certain that the geographical allocation of facilities would be fair, the Act divided the United States into five zones and provided that not more than one commissioner should be appointed from each zone. The Act contained an explicit prohibition of any exercise of censorship over radio by the licensing authority. Radio stations permitting any candidates for any public office to use their facilities were required to "afford equal opportunities to all other such candidates for that office." No obligation, however, was imposed on broadcasting stations to make their facilities available for political purposes in the first instance. If political broadcasts were permitted, the Act forbade censorship by licensees over the material broadcast. The Act also provided that all material broadcast for which payments were made should be so announced. In order to meet the danger of monopoly in radio, the licensing authority was directed to refuse a station license to "any person, firm, company, or corporation, or any subsidiary thereof, which has been finally adjudged guilty by a federal court of unlawfully monopolizing or attempting unlawfully to monopolize . . . radio communication."

The Radio Act of 1927 thus represented a very considerable expansion of federal regulatory power. It did not make broadcasting a public utility [15] in the sense of giving the Commission control over broadcasting rates and charges; but it did vest the Commission with considerable discretionary authority which might be used to determine the future structure of broadcasting and give direction to its development. In practice, however, the Commission showed itself loath to use its authority with vigor; its tendency was to accept the broadcasting structure as it had already taken shape. While the Com-

[15] Note the words of Justice Roberts in a recent radio case: "In contradistinction to communication by telephone and telegraph, which the Communications Act recognizes as a common carrier activity and regulates accordingly . . . the Act recognizes that broadcasters are not common carriers and are not to be dealt with as such. . . ." *F.C.C.* v. *Sanders Bros. Radio Station,* 309 U.S. 470, 474 (1940).

mission did not completely freeze the *status quo,* such piecemeal revision as was undertaken was largely a response to the more powerful pressures which played upon it.

The Commission's lack of independence found partial explanation in the weakness of its position. The Commission, as has been noted, was created for one year only. Its life as an administrative agency was precarious; its authority was renewed from year to year until 1930, when the agency was placed on a permanent basis. Its members were affected by the timidity that results from uncertainty of tenure. The Commission was handicapped by insufficient appropriations, which made it difficult to recruit adequate technical and legal personnel. Appointments to the Commission frequently were made solely on the basis of political patronage. The Commission was racked by internal friction and lacked the vision or courage to undertake departures from established norms and routines.

From the beginning, the Commission was a focal point for pressures of all sorts. It was fearful of criticism from Congress and, therefore, sensitive to Congressional appeals on behalf of local constituents. It found itself embroiled in sectional jealousies. It was reluctant to antagonize the more powerful commercial broadcasting interests with their established control of the more desirable facilities; at the same time it was exposed to demands from spokesmen for other groups who pressed for a greater share in the radio spectrum. In this unenviable position, it is perhaps not surprising to find that the Commission surrendered to the more insistent and powerful interests, and that its course of conduct was largely dictated by the expediencies of the moment.

The power to grant, modify, refuse, or revoke licenses is the heart of the Commission's authority. Under the law it must be exercised in accordance with the standard of "public interest, convenience, or necessity." "This criterion," as Chief Justice Hughes has said, "is not to be interpreted as setting up a standard so indefinite as to confer an unlimited power." [16] Yet at the same time it is vague enough to

[16] Chief Justice Hughes continues as follows: "The requirement is to be interpreted by its context, by the nature of the radio transmission and reception, by the scope, character, and quality of services, and, where an equitable adjustment between states is in view, by the relative advantages in service which will be enjoyed by the public through the distribution of facilities. In making such an adjustment, the equities of existing stations undoubtedly demand consideration. They are not to be victims of official favoritism. But the weight of the evidence as to these equities and all other pertinent facts is for the determination of the Commission in exercising its authority

give the Commission a considerable range of discretion in defining its content. To find out what it has meant, one must turn to the actions of the Commission and the courts. The Commission has never found it possible to set forth a comprehensive definition. Meaning has been poured into it by a process of "inclusion and exclusion," as the Commission and the courts [17] have faced the problem of deciding specific cases which come before them.

In a field as overcrowded as radio, where the petitioners for radio channels far exceed the available supply, exercise of the licensing power necessarily involves a constant process of balancing claims, of choosing recipients for public favor, and of justifying the choice in terms of the statutory standard. An analysis of the record of the Federal Radio Commission reveals that it inaugurated no fundamental changes in the system of broadcasting which had grown up prior to its creation. Commercial broadcasters were encouraged and others discouraged. Nonprofit broadcasters, including educational stations, were relegated to undesirable channels and hours and allowed only low power.

The principles which were used to justify this policy may be summarized briefly.[18] First, there is the principle of priority. As the Circuit Court of Appeals said in *Chicago Federation of Labor* v. *Federal Radio Commission:* [19] "It is not consistent with true public convenience, interest, or necessity, that meritorious stations . . . should be deprived of broadcasting privileges when once granted to them, which they have at great cost prepared themselves to exercise, unless

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to make a fair and equitable allocation." *Federal Radio Commission* v. *Nelson Bros. Co.,* 289 U.S. 266 (1933).

[17] Under the Radio Act of 1927, as originally passed, the Court of Appeals was authorized in reviewing action of the Radio Commission to "alter or revise the decision appealed from and enter such judgment as to it may seem just." Dissatisfaction with this procedure led to termination of "the administrative oversight of the Court of Appeals." In 1930 the Court of Appeals of the District of Columbia was restricted to a purely judicial review; findings of fact of the Commission, if supported by substantial evidence, were to be conclusive. Because much of the work of the Commission is reviewable in the Court of Appeals of the District, the Court of Appeals, in spite of the change in the law, has tended to intrude into the administrative process. This intrusion has recently been rebuked by the Supreme Court. See *F.C.C.* v. *Pottsville Broadcasting Co.,* 309 U.S. 134 (1940); *Fly* v. *Heitmeyer,* 309 U.S. 146 (1940).

[18] The problem of geographic allocation of facilities is discussed separately below. See pp. 391–394.

[19] 41 F.(2d) 422 (1930).

clear and sound reasons of public policy demand such action." While the court did not go so far as to say that licensees have a vested interest in a license, and it expressly pointed out that broadcasting privileges are held subject to the reasonable regulatory authority of the Commission, the principle was clear that the established station had prior rights, other things being equal.[20] Such a principle necessarily favored those who came in on the ground floor.

A second important criterion may be described as that of technical qualification. Here engineering standards, such as adequacy of equipment, tests of interference, and quality of technical personnel, serve as measuring rods. Since these, for the most part, are objectively verifiable and vital to the efficient operation of a radio station, the soundness of such criteria, if fairly applied, is unimpeachable.

A third criterion is the test of economic qualification. Does the applicant have sound financial standing? Is there a showing of adequate commercial support for the station? Will the station which proposes to compete with existing facilities find such support? Will the applicant make the most economic utilization of the license if it be granted to him? These and other economic factors may be said to favor those with strong financial backing and resources.

A fourth criterion which offers considerable scope for interpretation is that of serviceability to the listening public. This requirement has been interpreted as implying that the entire listening public within the service area of a station is entitled to service from that station, and that programs must be sufficiently well rounded to be of interest to all substantial groups represented in the listening public. So-called propaganda stations, which are the mouthpieces of particular social or economic groups and which are designed to appeal to particular groups in the listening public, get short shrift under this

[20] In an important recent case, *F.C.C.* v. *Sanders Brothers Radio Station,* 309 U.S. 470 (1940), the Supreme Court held that, since the Act does not afford an existing licensee protection against competition, "economic injury to an existing station is not a separate and independent element to be taken into consideration by the Commission in determining whether it shall grant or withhold a license." This conclusion was qualified, however, as follows: "This is not to say that the question of competition between a proposed station and one operating under an existing license is to be entirely disregarded. . . . It may have a vital and important bearing upon the ability of the applicant adequately to serve his public; it may indicate that both stations—the existing and the proposed—will go under, with the result that a portion of the listening public will be left without adequate service; it may indicate that, by a division of the field, both stations will be compelled to render inadequate service."

interpretation of serviceability.[21] The result of the application of these principles was to reserve the more desirable facilities to commercial broadcasters on the ground that the programs sponsored by these groups were of wide general interest and ministered to popular tastes.

THE FEDERAL COMMUNICATIONS COMMISSION

The abolition of the Federal Radio Commission in 1934 and the transfer of its powers to the newly created Federal Communications Commission involved few important changes in the radio field. Two members of the old Radio Commission, E. O. Sykes and Thad H. Brown, were reappointed to the new Commission; the new appointees initiated no fundamental changes in basic policy. A Broadcast Division, composed of Commissioners Sykes, Case, and Prall, assumed primary jurisdiction in the radio field. The statutory standards which they were called upon to administer were largely taken over from the Radio Act of 1927, and the new Commission showed little disposition to pour new wine into old bottles. The general framework of broadcast allocation which had been established earlier was left substantially unmodified. The trend toward development of broadcasting on a predominantly commercial basis continued. The Federal Communications Commission, like its predecessor, the Federal Radio Commission, continued to be a political storm center. Ugly charges of incompetence and corruption produced demands for investigation and reorganization; the announcement in the summer

[21] In refusing the request of the Chicago Federation of Labor (WCFL) for a modification of its license, permitting it to operate during the evening hours, the Commission (Chicago Fed. of Labor, No. 4972, June 25, 1929) observed: "There are not enough frequencies within the broadcast band to give to each of the various groups of persons in the United States a channel on which to operate a broadcasting station." In its decision in the *Great Lakes Broadcasting Company* case (4900–02, Feb. 1, 1929), denying a license to Voliva who represented a religious sect known as the House of David, the Commission wrote:

"Propaganda stations (a term which is used here for the sake of convenience and not in the derogatory sense) are not consistent with the most beneficial sort of discussion of public questions . . . if the question were now raised for the first time, after the commission has given careful study to it, the commission would not license a propaganda station, at least to an exclusive position on a cleared channel . . . while the commission is of the opinion that a broadcasting station engaged in public service has ordinarily a claim to preference over a propaganda station, it will apply this principle as to existing stations by giving preferential facilities to the former and assigning less desirable positions to the latter to the extent that engineering principles permit."

of 1937 of the appointment of Frank McNinch, former chairman of the Power Commission, as the new chairman of the Federal Communications Commission [22] was hailed as an administration effort to "clean house."

Under McNinch a number of reforms in organization and procedure were initiated. The old division of the Commission into Telephone, Telegraph, and Broadcast sections was abolished. This step was designed to end divided responsibility within the Commission. Important changes were made in leading personnel. The Examining Division, which formerly bore the brunt of regulation in the broadcasting field, was also eliminated. Strenuous efforts were made to bring the docket up to date and to infuse a new spirit into the administration of the radio laws.

SOME SIGNIFICANT CURRENT PROBLEMS

The present tendencies of the Commission can be most effectively portrayed through an analysis of its attitude toward the more important problems which are currently agitating the radio world. These problems will be considered under the following heads:

(1) geographic distribution of broadcasting facilities.
(2) concentration of control in the broadcasting industry.
(3) regulation and the advance of the art.
(4) the place of education in the broadcasting structure.
(5) the problem of censorship and program control.

GEOGRAPHIC DISTRIBUTION OF BROADCASTING FACILITIES

Under the Radio Act of 1927 the Commission was required to make such a distribution of facilities "among the different states and communities as to give fair, efficient, and equitable radio service to each of same." Dissatisfaction with the Commission's distribution under this formula led Congress in 1928 to enact the Davis Amendment, which provided for *equal* allocation of *station facilities* (as nearly as possible) to each of five zones, and for a *fair and equitable* allocation to states within each zone according to population. Under the Davis Amendment the Commission adopted a quota system designed to secure an equitable distribution of facilities among the various zones and states within zones. The rigid application of this

[22] Mr. McNinch has since been succeeded as chairman by James Lawrence Fly, former General Counsel of T.V.A.

quota soon gave rise to considerable litigation. While the courts upheld the constitutionality of the Davis Amendment, they did not always sustain the application which the Commission gave it. The Commission found it extremely difficult to reconcile the professed objectives of the Amendment with the equities involved in specific cases before it. Part of the difficulty was that the Davis Amendment emphasized equality of transmission facilities, rather than broadcasting service from the point of view of the listener. With commercial broadcasters naturally anxious to locate their stations in areas of maximum population density, rural listeners in sparsely populated areas found themselves disadvantaged. The Communications Act of 1934 made an effort to correct this disparity by permitting the Commission to license 100-watt stations regardless of quota restrictions; but, in view of economic obstacles to the establishment of small stations in areas of sparse population, this exemption did not go far to meet the problem. In 1936 the Davis Amendment was repealed and a new standard substituted which emphasized reception and provided for "a fair, efficient, and equitable distribution of radio *service*."

But economic obstacles remain to hinder adequate rural coverage. As former Commissioner Stewart of the F.C.C. has pointed out: "One corollary of the American system in which broadcast is supported by advertising revenue . . . is that . . . broadcasting stations are located where the advertisers want them, not where they will best serve the country as a whole."[23] There is intense competition to locate radio stations in areas of dense population, where the prospect of advertising revenue is great; there is relatively little demand to serve areas where population is sparse.

Superpower stations have been suggested as one way to meet the service needs of isolated rural areas. Several years ago the F.C.C. granted WLW, the Crosley station in Cincinnati, an experimental license to increase its power from 50 to 500 kilowatts. The success of this experiment impelled a number of other stations to request similar increases in power. In spite of the additional coverage made possible by superpower, the F.C.C., on February 6, 1939, refused to grant WLW an extension of its special experimental authorization, and a Committee appointed by the Commission brought in a recommendation against superpower.

[23] Address by Irvin Stewart, former vice-chairman of the F.C.C., at Duke University, March 23, 1937. Reprinted in R. S. Rankin, *Readings in American Government* (1939), pp. 275–276.

The Committee posed the issue in these terms:

Are the advantages to be gained in the improvement of radio service to listeners in rural areas by means of superpower outweighed by possible disadvantages resulting from adverse economic effects of such superpower operations upon a large number of smaller power stations primarily serving the smaller metropolitan areas, as well as by possible adverse social effects of centralizing into the hands of a few persons powerful facilities of mass communication capable of reaching all the population of the nation?

In the judgment of the members of the Committee the disadvantages loomed more importantly. They felt that the adoption of superpower would have harmful competitive effects upon other portions of the broadcasting structure—particularly on existing network operations and on the large number of smaller power stations primarily serving smaller urban areas. Superpower stations would scoop the national advertising business and squeeze the smaller local stations out of business. Advertisers would hardly be likely to use numerous low-power stations when they could reach the same market from one or more superpower stations. Furthermore, the Committee argued, one of the underlying purposes of the Communications Act of 1934 was the desire to prevent a concentration of control of broadcasting channels in the hands of any person or small group of persons, either in the government or elsewhere. Superpower raised the specter of monopoly. Considerations of social and economic expediency outweighed countervailing considerations of technical superiority. Meanwhile, under the new rules governing Standard Broadcast Stations (which became effective August 1, 1939), no provision was made for the use of power greater than 50 kilowatts.[24] The reception problem

[24] Under the new rules, provision is made for four general classes of stations. A Class I station is defined "as a dominant station operating on a clear channel and designed to render primary and secondary service over an extended area and at relatively long distances." Power is specified as 50 kilowatts. A Class II station is defined "as a secondary station which operates on a clear channel and is designed to render service over a primary service area which is limited by and subject to such interference as may be received from Class I stations." Power may be not less than 0.25 kilowatt nor more than 50 kilowatts. A Class III station is defined "as a station which operates on a regional channel and renders service primarily to a metropolitan district and the rural area contiguous thereto." Class III stations are subdivided into two classes: Class IIIA, which operates with a power not less than 1 kilowatt nor more than 5 kilowatts, and Class IIIB, which operates with power not less than 0.5 kilowatt nor more than 1 kilowatt night- and 5 kilowatts daytime. A Class IV station is de-

of the remote sparsely populated sections of the United States has still to be squarely met.

CONCENTRATION OF CONTROL IN THE BROADCASTING INDUSTRY

A frequently heard criticism in the radio field is that relatively little has been done to arrest the increasing concentration of control of broadcasting facilities. The policy of both the Radio Act of 1927 and the Communications Act of 1934 is reasonably clear. Under the Act of 1927, the Commission was directed to refuse broadcasting licenses to parties found guilty of unlawful monopoly in the radio industry. However, when RCA in 1931 was adjudged guilty of violating the antitrust laws, the Federal Radio Commission by a close vote of three to two decided that the statute did not require the revocation of RCA's licenses. The law as modified in 1934 now provides that when licensees are found guilty of violating the antitrust law the court so finding may in its discretion order a revocation of license. So far there has been no occasion to apply this section of the 1934 Act.

The cry of monopoly has recently been raised in connection with the spread of chain or network broadcasting. Both the Radio Act of 1927 and the Communications Act of 1934 give the Commission "authority to make special regulations applicable to radio stations engaged in chain broadcasting." Until very recently the Commission evinced no particular desire to embark on regulatory activity in this field. Meanwhile, the phenomenal growth of chains went on unimpeded. The National Broadcasting Company, which was organized by RCA, General Electric, and Westinghouse in 1926, expanded until by May, 1938, it owned and operated fifteen stations and had 135 affiliates divided between two subnetworks. Its most important competitor—Columbia, which was established in September, 1927—owned eight stations, leased one, and had 106 affiliates. A third network—Mutual Broadcasting Company, which was organized as a co-operative enterprise—had seventy-seven affiliates, some of which were also affiliated with NBC and CBS. In addition, there were a number of local or regional chains.

The three large coast-to-coast networks own a relatively small number of stations, but they provide programs for approximately 35 per

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fined "as a station operating on a local channel and designed to render service primarily to a city or town and the suburban and rural areas contiguous thereto." Power is limited to not less than 0.1 kilowatt nor more than 0.25 kilowatt. See *Fifth Annual Report*, F.C.C. (1939), pp. 38–39.

cent of the stations in the United States, including practically all of the more powerful ones. The networks reserve the most desirable hours for broadcasting. ". . . With three organizations in a position to determine what programs shall be carried on the most powerful broadcast stations all over the country at the time when most people are free to listen, it is small wonder," comments ex-Commissioner Stewart, "that the cry of monopoly has been raised."[25] On March 18, 1938, the Commission, in response to such criticism, ordered an investigation of chain broadcasting and monopoly in the broadcasting field in order to determine the "extent and effects of concentration of control of stations locally, regionally or nationally in the same or affiliated interests, by means of chain or network contracts or agreements, management contracts or agreements, common ownership or other means or devices, particularly in so far as the same tends toward or results in restraint of trade or monopoly."

On June 12, 1940, the long-awaited Monopoly Report appeared. It was signed, however, by only three Commissioners—Brown, Thompson, and Walker—instead of by the entire Commission. According to the three Commissioners: "The record discloses an unhealthy predominance of the network organizations in the radio-broadcasting field, which is due in large part to the contractual arrangements forced upon stations seeking affiliation with a network." The only recommendation made by the Committee was that the F.C.C. utilize its authority to regulate chain broadcasting to eliminate "inequitable and arbitrary contractual arrangements between the networks and their outlets." The Committee members, however, suggested a number of other "problems" for consideration, among them: (1) the necessity and advisability of requiring the networks to be licensed by the Commission; (2) the ownership of stations by networks; (3) the control of talent by networks; (4) the dominant position of NBC in the transcription field; (5) the difficulties involved in supervising the transfer of control of corporate licensees with stock listed on the exchanges.

Another aspect of the monopoly problem which deserves attention is the increasing penetration of newspaper control in the broadcasting field. As has been pointed out in a recent dissenting opinion, about two hundred of the less than seven hundred broadcasting stations in existence are controlled by newspapers.[26] The increase in newspaper

[25] Rankin, *op. cit.*, p. 277.
[26] 3 F.C.C. 628 (1937).

ownership has been particularly rapid in recent years, as publishers have sensed the dangers of radio as a competitive advertising and news-dispensing medium. The inroads of publishers into radio have evoked alarm and criticism.

> Where the newspaper and the broadcast station are separately controlled, the listener may receive the full benefit of both—[says Commissioner Stewart] . . . he has more chance to decide for himself what is really happening, what its influence upon him, his family, his community, his country is likely to be. Obviously the newspaper and the broadcasting station cannot be checked against each other when both are under the same control. To some this solicitude for channels of information independent of each other may seem a counsel of confusion; to me, it is a principal hope of democracy.[27]

The licensing authority which the Commission enjoys gives it, theoretically at least, complete power to prevent monopoly if it chooses to exercise its authority. The increase in concentration of control ordinarily occurs through the transfer of licenses of existing stations rather than through the construction of new stations. The consent of the Commission is necessary in order to validate transfers of ownership. In the past such consent has been freely given; there has been little disposition on the part of the Commission to inquire into the conditions or consequences of the transfer. In a number of cases, moreover, the Commission has given its approval to transfers of licenses at prices far in excess of the value of the physical equipment of the stations. This policy raises serious questions. Under the radio laws there is no vested interest in a license beyond the term it has to run. The Commission, however, by approving inflated prices for station equipment, has, in effect, permitted station owners to capitalize expectancies of license renewals; it has approved claims which it may be obligated to honor. Vested interests built up in this fashion and perhaps subject to judicial protection may seriously hamper any fundamental change in broadcasting policy, should such change be deemed desirable. Meanwhile, in connection with the launching of new frequency modulation service, it is worth noting that the F.C.C. has taken action to avoid "concentration of control." Under the new rules for the licensing of frequency modulation stations, no one person or organization is to be licensed to own more than six stations, no two of which may be in the same area.

[27] 3 F.C.C. 626, 627 (1937).

REGULATION AND THE ADVANCE OF THE ART

One of the most interesting provisions of the Act of 1934 is the requirement [Sec. 303(g)] that the F.C.C. "study new uses for radio, provide for experimental use of frequencies, and generally encourage the larger and more effective use of radio in the public interest."

In few fields of activity is the pace of technical change as rapid as in radio. Among the new developments are television, facsimile reproduction, the invention of the coaxial cable, the practical extension of the radio spectrum to include a great many new high-frequency channels, and the introduction of a new system of broadcasting called frequency modulation, in contrast with the system of amplitude modulation under which radio broadcasting has hitherto been accomplished. The development of each one of these innovations is dependent upon a willingness on the part of F.C.C. to provide facilities for "experimental use of frequencies," and ultimately for commercial exploitation. The Commission's control of the ether thus gives it a strategic position of great importance. Technical innovations come as disturbing interruptions to routine. The F.C.C., as the regulator of the pace of change, is exposed to pressure from all sides—both from the interests that find their established positions threatened by new discoveries and from the groups which stand to benefit by new technological blessings. Each innovation presents its own problem. With frequency modulation, it is the problem of competition with amplitude modulation and the probability that old-style transmitters and receivers will be rendered obsolete if frequency modulation finds favor. The impact of television on other entertainment agencies is likely to be great. Problems such as these do not lend themselves to easy resolution.

Thus far, the F.C.C. has held back on commercial television. Its outstanding licenses authorize their holders to engage in television only on an experimental basis. Commercial exploitation would require agreement on defined standards. "To standardize too soon," as ex-Commissioner Stewart points out, "may mean a standardization which might retard development. To standardize at all may mean to deliver television into the hands of a monopoly controlling the patents essential to meet the specified standards." [28] Before television may be put into operation, policies must be determined which will ensure its utilization in the public interest. Meanwhile, on May 18, 1940, the

[28] Address at Duke University, March 23, 1937.

F.C.C. released a report authorizing the commercial exploitation of frequency modulation and outlining the pattern of organization for this new type of broadcasting. The Commission has taken steps to reserve certain frequencies for educational institutions and to encourage competition in the development of frequency modulation.

Other innovations impend. Facsimile reproduction is already well advanced. It is not inconceivable that newspapers shortly will be brought directly into the home by radio facsimile. Should this development become commercially feasible, it would have revolutionary effects on the newspaper business. With this in mind, far-sighted publishers are seeking to gain a firm foothold in the radio field in order to protect their interests. In these developments the F.C.C. is necessarily an arbiter. The responsibility which faces the Commission is nothing less than mediation between innovation and its social and economic consequences. Here is a real challenge to a regulatory tribunal.

THE PLACE OF EDUCATION IN THE BROADCASTING STRUCTURE

One of the many controversial subjects which has arisen in connection with radio regulation in the United States is the place of education in the broadcasting structure. The controversy has centered chiefly around the allocation of broadcasting facilities as between commercial and educational purposes. The criticism from educational circles stresses the view that the Commission has sacrificed educational to commercial broadcasting, that most commercial broadcasters only use educational programs in the absence of paying material, or where they wish to placate criticism or build good will. As a result of pressure from educational groups, Congress provided in the Act of 1934 that the F.C.C. "study the proposal that Congress by statute allocate fixed percentages of radio broadcasting facilities to particular types or kinds of nonprofit activities, and report to Congress, not later than Feb. 1, 1935, its recommendations, together with the reasons for the same." After lengthy hearings, the Commission concluded that it was inadvisable to make such an allocation and proposed a conference between broadcasters and educational organizations at which plans for mutual co-operation might be discussed. As a result of this conference, a Federal Radio Education Committee, composed of representatives of the broadcasting industry and the public, was established. Under the auspices of this Committee, a limited amount of experimental work in educational broadcasting has been

launched. But the Committee has not been notably active or effective. Individual commercial broadcasting stations have shown a willingness to co-operate where interesting educational programs are offered, but they demonstrate an understandable reluctance to sponsor dull programs and a grim determination not to sacrifice lucrative revenue-yielding commercial programs in favor of educational features which bring in no tangible income.

The full potentialities of the radio as an educational instrument can hardly be realized when the most desirable hours on the most desirable stations are reserved for other purposes. Some recent actions of the Commission indicate an awareness of the needs of educational broadcasters. A special band of frequencies in the newly developed high-frequency portions of the radio spectrum has been reserved for educational broadcasters and will be available for stations using both frequency and amplitude modulation. Stations in this range, however, are outside of the reach of most listeners at present. Educators interested in radio, therefore, press for concessions which will have more immediate significance. Among the proposals discussed are: (1) definite legal provisions requiring broadcasting companies to use a certain portion of their facilities for education; (2) a privately endowed educational network; and (3) a government-owned and operated educational network. If commercial broadcasters reveal themselves unable or unwilling to meet educational needs, the pressure for a more radical solution of the problem is likely to increase.

CENSORSHIP AND PROGRAM CONTROL

The significance of the radio as a medium of mass communication needs no underlining. Access to radio facilities has become vital in determining public opinion and public policy. It is important, therefore, to inquire into the nature of the controls exercised over what is said and heard over the air. The relevant sections of law are concise. Section 326 of the Communications Act provides:

> Nothing in this Act shall be understood or construed to give the Commission the power of censorship over the radio communications or signals transmitted by any radio station, and no regulation or condition shall be promulgated or fixed by the Commission which shall interfere with the right of free speech by means of radio communication. No person within the jurisdiction of the United States shall utter any obscene, indecent, or profane language by means of radio communication.

Section 315 reads:

> If any licensee shall permit any person who is a legally qualified candidate for any public office to use a broadcasting station, he shall afford equal opportunities to all other such candidates for that office in the use of such broadcasting station, and the Commission shall make rules and regulations to carry this provision into effect: *Provided,* That such licensee shall have no power of censorship over the material broadcast under the provisions of this section. No obligation is hereby imposed upon any licensee to allow the use of its station by any such candidate.

In exercising its powers under these provisions, the Commission has taken the position that it does not have authority to make regulations governing the content of programs because of the statutory prohibition against censorship. At the same time, it has made clear that in considering applications for the renewal of licenses, it would take into consideration the past conduct of applicants, including the content and character of programs sponsored by them. Is not this power to scrutinize programs, some critics ask, the virtual equivalent of censorship?

An analysis of cases where the Commission has refused to renew licenses because of program content indicates that in the great majority the avowed reasons have been objectionable advertising or indecent and defamatory utterances.[29] On the whole, a good case can be

[29] In denying the application of Norman Baker for a renewal of the license of Station KTNT, the Commission pointed out: "The programs broadcast by Station KTNT have included personal and bitter attacks upon individuals, companies and associations, and whether warranted or unwarranted, such programs have not been in the public interest, convenience or necessity . . . this record discloses that Mr. Baker . . . continually and erratically over the air rides a personal hobby, his cancer cure ideas and his likes and dislikes of certain persons and things. . . . Many of his utterances are vulgar, if not indeed indecent. Assuredly, they are not uplifting or entertaining. Though we may not censor, it is our duty to see that broadcasting licenses do not afford mere personal organs, and also to see that a standard of refinement fitting our day and generation is maintained."

In the *Shuler* case, involving the renewal of the license of Station KGEF, one of the grounds the Commission gave for the denial of the license was the following: "The principal speaker over this station has repeatedly made attacks upon public officials and courts which have not only been bitter and personal in their nature, but oftentimes based upon ignorance of fact for which little effort has been made to ascertain the truth thereof." The action of the Commission in this case was upheld by the Court of Appeals. The court said: "Every free man has an undoubted right to lay what sentiments he pleases before the public: to forbid this is to destroy the freedom of the press . . . but this does not mean that the government, through agencies

made out for the proposition that the Commission has been more zealous in guarding the freedom of the air, particularly in the case of political broadcasting, than have individual broadcasters. Thus, when a broadcasting station which had carried for pay the speeches of candidates Roosevelt and Landon in the 1936 election refused to carry for pay the speech of the Communist candidate Browder, the Commission intervened with a demand for an explanation, and the station owner was persuaded to let Candidate Browder speak. In another instance, where two California stations refused to carry an address by the President of the United States without payment, the Commission upheld the stations on the ground that they were acting within their legal rights. The rules promulgated by the Commission in July, 1938, are designed to enforce the statutory requirement that if a station's facilities are made available to any candidate for a public office they shall be made available to all candidates for that office on the same terms. Under the new rules governing political broadcasts, every licensee is required "to keep and permit public inspection of a complete record of all requests for broadcasting time made by or on behalf of candidates for public office, together with an appropriate notation showing the disposition made by the licensee of such requests, and the charges made, if any, if the request is granted."

But even if these rules are applied with the utmost fairness it nevertheless remains true that a more subtle type of censorship is inherent in the present system of radio control. The basic decision to develop broadcasting on a commercial basis has had the effect of making it extremely difficult for financially weak groups to obtain station licenses. The law as it operates ensures a hearing in political contests where financial resources are available; minority groups without adequate resources find themselves penalized. If such groups are to get a hearing at all, they must depend on the good will of station owners.

All too frequently, the problem of censorship and program control is discussed in terms which seem to indicate that the only danger of censorship comes from the Commission. While the record of the Com-

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established by Congress, may not refuse a renewal of a license to one who has abused it to broadcast defamatory and untrue matter. In that case there is not denial of the freedom of speech, but merely the application of the regulatory power of Congress in a field within the scope of its legislative authority." *Trinity Methodist Church South* v. *F.R.C.* 62 F. (2d) 850 (1932).

These quotations reveal the tenor of the Commission's thinking on the subject of program control; they do not provide final answers to the question of how far control of programs can be carried before it passes over into censorship.

mission is not without blemish, to confine one's critical attention to it is to ignore the very considerable range of discretion which the station owner enjoys to carry such programs as he pleases and to refuse such as he deems undesirable. Usually this power is not called censorship—it is called "editorial selection"—but, however described, it remains true that station owners can, and sometimes do, refuse to carry programs contrary to their own views and interests. Facts regarding station censorship are not easy to obtain and verify, but instances are available where station owners have explored the full measure of their discretion.[30]

In exercising the power of "editorial selection," station owners may reflect diverse influences—their own economic interests, the pressure of advertisers, the demands of the radio audience (or particularly active pressure groups within it), or the anticipated reaction of the regulatory agency. Station owners are ordinarily anxious to minimize the influence of the regulatory agency and, at the same time, they are not particularly anxious to outrage any strong drift of public sentiment. The result has been a species of self-censorship, exercised through the adoption of a code by the National Association of Broadcasters, the trade association of the industry.[31] This code covers such matters as children's programs, news broadcasts, and the discussion of controversial public questions. With reference to controversial public issues, the code provides that the radio may not be used to convey attacks upon another's race or religion and that time for presentation of controversial issues is not to be sold except during political campaigns. When free time is made available for political discussion, the amount of time allotted is to be determined by the degree of public interest in the question, and the question must be presented with fairness to all elements in the controversy.[32]

[30] Ruth Brindze, *Not To Be Broadcast* (1937).

[31] See *The Code of the National Association of Broadcasters,* adopted by the 17th Annual Convention of the N.A.B, July 11, 1939.

[32] The following statement made by Mr. William S. Paley, President of the Columbia Broadcasting Corporation, in 1935 is of interest:

"It is our fixed policy not to sell time for propaganda of any sort. When we think the public is sufficiently interested in a subject suitable for discussion over the air so that propagandists of opposing sides should be heard, we allot time without charge."

Defining propaganda, Mr. Paley continued:

"What I mean [by propaganda] in a general way is this: We would not, for example, sell time to the public utility holding companies to agitate against proposed legislation restricting or regulating their operations. We would and did give them

What the result of the adoption of this code will be still remains to be seen. Can station owners be trusted to exercise self-restraint where their own immediate economic interests are imperiled? Is the American combination of a commercially organized broadcasting system and a government regulatory commission a sufficient guarantee that controversial public questions will be discussed fairly? Would a different technique of regulation be preferable? Do the Canadian and Australian expedients of a chain of government stations existing side by side with privately owned stations hold out more promise? These questions are raised not to provide answers, but to focus attention on the problems of control which underlie them.

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time in which to argue against this proposed legislation just as we gave the advocates time to argue in favor of such legislation.

"On the other hand, if the public utilities wanted to buy time to advertise their goods and services—that is, to promote the use of gas and electricity—we would unhesitatingly sell them available time for such use. To illustrate a little further, we sell time to commercial sponsors for the promotion of the sale of their goods and services or the creation of institutional good will, but we do not allow them such bought time to agitate for high or low tariffs, changes in national or city or state tax structures, or other things of that nature."

The distinction of which Mr. Paley speaks may sometimes become tenuous in its application.

Chapter Twelve. GOVERNMENT AND THE INVESTOR

1. The Rise of the Securities Investment System

A century ago, ownership of wealth took the form largely of possession of physical property such as land, merchandise, ships, and mills. With the growth of corporate enterprise and the spread of the securities investment system, ownership of wealth has come to be represented, in large part, by paper claims to property, stocks and bonds which can be bought and sold in small denominations and which are freely traded on the security exchanges. In 1932 the ratio of outstanding securities to national wealth reached the high figure of 73.5 per cent, $181,000,000,000 out of an estimated national wealth of $246,400,000,000.[1]

The economic welfare of the American people has become intimately dependent on security investments and on fluctuations in their value and return. Through the mechanism of investment in securities, private savings flow into productive enterprise and give direction to the nation's economic development. Proper performance of the investment function is crucial to efficient allocation and utilization of economic resources.

Although precise data on security ownership in the United States are lacking, reliable estimates indicate the existence of more than ten million individual security holders.[2] In addition, many more millions have an indirect, but nonetheless real, stake in security investments.

Everyone who has a bank account, who owns life insurance, or who is a beneficiary of an endowed institution of any type . . . is affected by

[1] G. W. Edwards, *The Evolution of Finance Capitalism* (1938), p. 274.

[2] Twentieth Century Fund, *The Security Markets* (1935), p. 35.

the changing values of stocks and bonds. . . . Through ownership of life insurance policies and payment of insurance premiums, a considerable portion of which is invested in bonds, more than 50 million persons are indirectly, but nonetheless vitally, interested in the security markets. More than 13 million have deposits in mutual savings banks, and at least twice this number have deposits in national and state banks and trust companies.[8]

The spread of the securities investment system is a relatively recent development in the United States. In the first half of the nineteenth century the amount of investment in securities was slight. Securities were sold, not to the general public, but mainly through private banks to a small number of wealthy individuals in this country and abroad. The rise of the modern investment banker is essentially a post-Civil War phenomenon, developed out of the need to mobilize capital for the expanding programs of corporate enterprise. In performing this function, the investment banker began essentially as a middleman, buying securities from corporations and governmental units and selling these securities to investors with available capital. As investment banking houses gained in strength, their aims became more ambitious. Through an extension of their influence into industry, they were able to exercise some control over the sources of the demand for investment funds. At the same time, they sought to expand their power over the supply of capital resources and credit controlled by insurance companies, trust companies, and commercial banks. The classic example of successful penetration in both these directions was furnished by the activities of the House of Morgan; other investment banking firms played lesser roles.

Prior to the first World War, securities were purchased by less than 500,000 individual investors in the United States. A mass market had not yet developed. During the war the Liberty Loan campaigns popularized the purchase of securities by small investors. During the twenties, moreover, many large corporate enterprises, particularly in the public utility field, embarked on direct sales campaigns of their own—employee and customer ownership campaigns—which added hundreds of thousands of shareholders to their lists. Investment trusts had a mushroom growth and also competed for the savings of small investors. The result was a tremendous increase in the number of direct investors and a revolution in the organization of investment

[8] *Ibid.*, pp. 35–36.

banking. Instead of catering to a market of 500,000, securities sales organizations were developed to tap a potential market of more than 10,000,000 customers.

The distribution of large blocks of securities often involved complex organization. A concrete case, the flotation of the Dawes Loan of $110,000,000 in 1924, will serve to illustrate the procedures employed.

The managing bankers, J. P. Morgan & Company, bought the loan at 87. They then formed an "originating group" composed of themselves and nine other banks or dealers, to whom they sold the loan at 87¼. The "originating group" then organized an "underwriting group" of 146 firms who took participation in the loan at a price of 87¾. This group then resold to a "selling group" of 1,094 members, mostly dealers, who bought the securities from the "underwriting group" at 89 and resold them to the public at 92. The result of these operations was a spread of five points between the price paid by the managing bankers and the price paid by the public. The spread was divided, ¼ point for the managing bank, ½ point for the originating group, 1¼ points for the underwriting group, and 3 points for the selling group. Some bankers were members of all three groups. Thus the National City Company, which bought $16,500,000 in bonds as a member of the originating group, retained $10,000,000 as a member of the underwriting group, and disposed of $8,000,000 as a member of the selling group. Its net profit, after all expenses were paid, was a little over $350,000; the profits of J. P. Morgan & Company as managing banker and as a member of the originating group amounted to $865,000. The total gross profits represented by the spread were $5,500,000.

What functions did these various participants perform in the security distribution system? The managing bankers, J. P. Morgan & Company, undertook the sponsorship of the loan and the burden of preliminary investigation before the decision to sponsor was reached. Since the issue was a large one, they determined to share initial financial responsibility with other members of the originating group. The organization of the underwriting group helped to spread the risk of the issue. In this instance, members of the "selling group," who actually made sales directly to investors, assumed the risk for that portion of the issue which was allotted to them. In some cases, members of the selling group may operate solely on a commission basis.

One further step frequently employed in the distribution of securities needs to be mentioned. A security issue was usually offered to the public at a fixed price. If, however, the securities should develop price weakness in the course of distribution and become available in the open market at a price below that set by the selling group, the selling group would encounter real difficulty in disposing of the unsold portion of the security issue at the agreed price. Consequently, the underwriting group usually maintained what was called a trading account. The manager of this account stood ready to buy the security in the open market at the price fixed. This function was usually called "pegging, fixing, or stabilizing" the market. When the need for this market support had ceased, that is, when the security issue was in the hands of the public, the manager of the trading account usually pulled the peg, liquidated such holdings as remained, and allowed the issue to find its own price in the market.

2. Abuses in Investment Banking and the Securities Markets

An investment banking system, organized in this fashion, presented elements of danger to the ordinary investor. Unless the originating bankers and underwriters thoroughly investigated the borrowing corporation or unit and made adequate disclosure of all relevant data, unless the investor knew how much of the price he paid for his security went to the borrower and how much was absorbed by the distribution "spread," unless he could be assured that the investment banker was not abusing his trust by market manipulations in the distributed security or by letting certain favored clients in on the ground floor, the investor might find himself in no position to appraise the value of securities and might lose all confidence in the integrity of the machinery by which securities were distributed.

There was much in the experience of the twenties to shake the confidence of the small investor in the securities distribution system. The twelve thousand printed pages of the hearings before the Senate Committee on Banking and Currency, conducted from 1932 to 1934, are filled with shocking revelations of incompetence and carelessness, of irresponsibility and abuse of trust by prominent personages engaged in the investment banking business. In no field were these abuses more glaring than in the field of foreign financing. According to the Senate Committee's computations, out of $3,200,000,000 worth of securities of foreign corporations outstanding as of March 1,

1934, $1,400,000,000, or approximately 43 per cent, were in default. Out of $5,000,000,000 in foreign government securities, over $1,500,000,000 were in default. The Senate Committee, after listening to testimony for two years in regard to these transactions, concluded: "The record of the activities of investment bankers in the flotation of foreign securities is one of the most scandalous chapters in the history of American investment banking. The sale of these foreign issues was characterized by practices and abuses which were violative of the most elementary principles of business ethics." [4]

Dubious practices were not confined to the foreign field. A source of abuse which has since been legislated out of existence [5] developed from the interrelationships of commercial and investment banking. Large commercial banks sometimes organized affiliated investment companies and employed these affiliates to speculate in bank stock, to participate in market operations designed to manipulate the price of securities, and to conduct other operations in which commercial banks themselves were forbidden by law to engage. The Senate investigation revealed numerous instances where investment bankers sponsored issues which created unsound and unfair corporate structures. Perpetual option warrants were issued enabling the sponsoring banker to purchase common stock of the corporation at a fixed price over an unlimited time. In some cases voting trusts were established by which the owners of stock were compelled to surrender their franchise. The pre-emptive rights of stockholders to subscribe to additional issues of stock were circumvented. Provisions for substitution of collateral were included in trust indentures without adequate safeguards to maintain quality.

Meanwhile, investment bankers were frequently paid well for their labors. According to the Senate Committee, in connection with the issue of United Corporation stock in 1929, "J. P. Morgan & Company received 1,514,200 option warrants on United Corporation stock for which they paid $1 each. Within 60 days thereafter, J. P. Morgan & Company was in a position to sell these warrants in the market at a minimum price of $40 [each] for a total profit of over $68,000,000." [6]

[4] *Report* of the Senate Committee on Banking and Currency, *Stock Exchange Practices* (1934), 73rd Cong., 2nd Sess., p. 125.

[5] The Banking Act of 1933 provides for a complete severance of commercial banking from investment banking.

[6] Senate Committee, *Stock Exchange Practices,* p. 115.

Sometimes investment bankers shared their profits with a selected list of influential individuals by offering securities to them at a price considerably below that available to the general investor. J. P. Morgan, Kuhn, Loeb, the National City Company, and other prominent investment banking firms all had their "preferred lists," and some individuals high in the economic and political world shared in the bounty.

Lax practices in investment banking had their counterpart in serious abuses in the security markets. Directors, officers, and principal stockholders of corporations were in some cases able and willing to utilize confidential information, which came to them by virtue of their positions, to aid themselves in their market activities. Pools and other varieties of manipulation were common practices. In the late twenties credit was freely available for speculation and margin purchasing became a national pastime. While stock quotations soared dizzily upward the speculative debauch was unrestrained, but with the collapse of the stock market in 1929 came heavy losses and disillusionment. During the years of depression which followed, attention turned to the reform of investment and financial practices.

A series of laws was enacted to achieve such reforms. The passage of the Securities Act of 1933 marked the beginning of a new era of investor protection. That Act, however, was focused only on the issuance of new securities. In 1934 the Securities Exchange Act extended regulation to the securities markets and created the Securities and Exchange Commission, a bipartisan body of five members, to administer the Acts of 1933 and 1934. The next year the Public Utility Holding Company Act extended the regulatory authority of the S.E.C. into the field of utility holding company organization and finance.[7] Subsequently the jurisdiction of the Commission was expanded to embrace broadened authority with respect to the over-the-counter markets, to provide for participation in corporate reorganizations, and to regulate trust indentures, investment trusts, and investment advisers. As a result of this cumulative grant of power, the S.E.C. has become the paramount administrative guardian of the interests of investors in the corporate sector of the American economy.

[7] The discussion of the Holding Company Act will be found on pp. 337–346, above.

3. The Securities Act of 1933

To understand the Securities Act in its proper perspective it is necessary to be familiar not only with the immediate abuses which precipitated it, but also with previous legislative efforts (some on this side of the Atlantic, but more on the other) which have been made to protect the interests of investors.

England particularly has had a rich experience in this field. With the growth of corporate enterprise in the nineteenth century, a Select Committee on Joint Stock Companies was appointed to investigate the need for adequate control. Under the chairmanship of W. E. Gladstone, the Committee drew up a notable report which was made public in 1844. It embodied the two basic principles of our own Securities Act—first, that the investing public should be supplied with adequate means for knowing the real financial state of a concern, and, second, that those issuing securities should be held legally responsible for supplying full and accurate information to investors.[8]

The British Companies Act of 1844, which enacted the recommendations of Gladstone's Committee, provided for the registration of company prospectuses. It introduced the principle of compulsory disclosure of relevant information concerning security issues. Subsequent acts enlarged the principle and widened the area of specific disclosures required. Through this legislation the principle of full disclosure became securely established among the accepted and respected conventions of English business. In the United States the draftsmen of the Securities Act of 1933 drew upon this experience.

They also drew upon earlier American efforts to provide protection for investors. The call for federal legislation to protect investors did not suddenly spring forth in 1933 as something completely new and strange in the American scene. There had been earlier effort to secure the passage of a federal incorporation bill.[9] A generation ago Louis D. Brandeis published his *Other People's Money,* in which he made an impressive analysis of traps and pitfalls which beset investors, reminded his readers of the legislative advances made in

[8] In the words of the Committee: "periodical accounts, if honestly made and fairly audited, cannot fail to excite attention to the real state of a concern; and by means of improved remedies, parties to mismanagement may be made more amenable for acts of fraud."

[9] President Taft supported federal incorporation.

England, and called for full and complete disclosure of facts in the security marketing business. In 1920 legislation was enacted which gave the Interstate Commerce Commission some control over railroad financing.[10] At the same time some efforts were made by the stronger public utility commissions to supervise the financial operations of companies subject to their jurisdiction.[11]

Beginning with Kansas in 1911, most states enacted legislation, later to be called "blue-sky" [12] laws, which purported to regulate the sale of securities. These laws varied widely in their scope and character. Some merely provided penalties for fraud. Others required the registration of security salesmen or the licensing of dealers, but not registration of securities. Still others provided for the registration of securities, but involved no control over dealers. The best type combined both kinds of control. Regulation under these statutes was very limited. Occasional get-rich-quick schemes were exposed, but inadequate administrative provisions for enforcement, as well as jurisdictional difficulties, condemned the "blue-sky" laws to relative ineffectiveness.

In utilizing this reservoir of experience, the draftsmen of the Securities Act of 1933 turned to the British Companies Act as their primary model. The main emphasis of the Securities Act is on publicity. The federal government does not undertake to *control* capital investments or *guarantee* the soundness of securities; it does seek to compel the disclosure of all relevant information concerning new security issues, so that the investing public will at least have an opportunity to know and understand what it is buying. The Act applies only to securities publicly offered and sold in interstate commerce or through the mails. It does not affect the ordinary redistribution of securities after issue, unless such redistribution is, in effect, a new offering. Certain transactions and security issues are exempt from the application of the Act. These exemptions include securities disposed of privately without a public offering, governmental securities, and the issues of banks, railroads, and co-operatives.

In the case of securities subject to the Act, the statute requires the filing of a registration statement with the Securities and Exchange

[10] See above, p. 262.

[11] See above, p. 311.

[12] This term apparently was coined in a judicial opinion which criticized "speculative schemes that have no more basis than so many feet of blue sky." *Hall* v. *Geiger-Jones*, 242 U.S. 539 (1917).

Commission.[13] The information contained in this document is public information from the date of filing. A prospectus containing a digest of the registration statement must be given to all persons to whom the securities are offered for sale. In order that the Commission and the public may have an opportunity to examine the statement before the securities are put on the market, no public offering of securities can be made until twenty days have elapsed after the registration statement has been filed and permitted to become public information.

This compulsory, twenty-day "cooling period" is designed to give the Commission and the sober, careful investor an opportunity to examine the security issue, and to do away with some of the high-pressure methods of the past by which distributors, dealers, and investors were frequently forced to make commitments blindly. The information which must be furnished in the registration statement is intended to reveal facts essential to a fair judgment of the security offered. The various items required include information concerning the character and scope of the business; its corporate structure; a statement of the specific purposes for which the new money is to be used; balance sheets and statements of earnings and operations for at least three years preceding the issuance of the securities in the case of old businesses; compensation of officers, direct and indirect; information concerning stock options; the nature of the underwriting contract, etc. In the case of new promotions the information required is even more detailed and is designed to reveal the character of the promoters, the nature of the promotional process, and the amount of compensation to be received either directly or indirectly by the promoters.

The Securities Act, by providing a variety of sanctions, attempts

[13] Until the creation of the S.E.C. in 1934, administration of the Securities Act of 1933 was vested in the Federal Trade Commission. Note the following statement of James M. Landis, former chairman of the Securities and Exchange Commission. "Despite the fact that I took a contrary position in 1934, today I am convinced that securities regulation has had a happier history through having had its administration intrusted to a separate commission rather than continuing the Federal Trade Commission as the administrative authority. . . . By creating a new commission . . . it was possible to have individuals in charge whose single concern was the problem of securities regulation. They were thus not required to dissipate their energies over a wide periphery by being responsible for the determination of problems of equal public importance but which bore no discernible relationship to securities regulation." J. M. Landis, *The Administrative Process* (1938), pp. 26–27.

to make reasonably certain that all of these items will be fully and correctly answered. These sanctions fall into three main groups: (1) administrative; (2) criminal; and (3) civil.

In exercising its administrative powers, the Commission is authorized to issue a stop order refusing to permit a registration statement to become effective (thus delaying marketing of the securities). It may also issue a stop order suspending an effective registration statement if it appears, on further investigation, that the statement contains a material falsehood or omits something which the statute required to be stated.[14] In order to avoid invoking this drastic remedy, informal procedures have been developed to clear up defects in the registration statement before it is permitted to become effective. The major device is the so-called "deficiency letter," by which the registrant is informed of weaknesses in his statement and an opportunity is afforded to offer amendments. Sometimes deficiency letters are supplemented by conferences. In this fashion formal proceedings are frequently avoided.[15] If the Commission refuses to permit registrations to become effective or revokes such registrations, it becomes illegal to use the mails and the channels of interstate commerce for the sale of the specific securities involved and the Commission may apply for an injunction to prevent such use. In addition to injunction proceedings, the Act authorizes the Commission to refer cases to the Department of Justice for the institution of criminal proceedings. Willful violation of the law is punishable by a fine of not more than $5,000 or imprisonment for not more than five years, or both.

The Act also imposes civil liabilities on registrants and those participating in the preparation of registration statements. Persons suffering losses resulting from false registration statements may sue

[14] In *Jones* v. *S.E.C.* 298 U.S. 1 (1936) the Supreme Court upheld the right of a registrant to withdraw his registration statement before the expiration of the twenty-day "cooling period" and thus avoid a threatened stop order. Justices Cardozo, Brandeis, and Stone dissented.

[15] Note the following observation by a former chairman of the Commission: "The major reforms in regard to underwriting practice, corporate disclosure, and accounting techniques that the Commission has brought about . . . are not of public record. The trend of decisional policy is not readily discoverable from the stop order opinions of the Commission. The nature of these reforms can only be found by an examination of the successive amendments made by issuers of securities prior to the effective date—amendments made in the hope that the corrected form of disclosure will avert the bringing of a proceeding." J. M. Landis, *The Administrative Process* (1938), p. 109.

those responsible for the falsehood for the recovery of damages. The civil liability provisions of the original Act were amended in 1934, after charges that their drastic character had served to deter new financing. Under the amended Act, the defendant may reduce his liability to the security buyer to the extent that the defendant can prove that any portion or all of the loss suffered was not caused by the mistake in the registration statement. The burden of proof, however, is still on the defendant. The original Act permitted recovery by anyone who had purchased the security upon a stock exchange or elsewhere, even though he had never seen a prospectus; under the amended Act the purchaser must prove reliance on a prospectus containing the mistake, if the security was purchased after the date of publication of an earning statement covering a twelve-month period after registration. Where formerly suits could be brought up to ten years after the public offering, the period has now been reduced to three, and the courts may require that bonds be posted to pay court costs if the suit is proved to be without merit. Under the original Act all persons except the issuer might escape liability if they could show that they acted in good faith and with reasonable caution. The standards of care and competence were those required of a fiduciary. The 1934 amendments eliminated the fiduciary test and provided that "the standard of reasonableness shall be that required of a prudent man in the management of his own property." What this means, the courts have still to decide.

At the time the Act was adopted, it was widely believed that the investor's principal protection would be derived from the civil liability provisions of the Act. These provisions were a focal point of controversy. Up to the present, however, civil suits have not, in fact, been important. Instead, the administrative sanctions have served as the main line of defense. False statements which would subject registrants to civil liability are ordinarily detected before harm can be done.

The impact of the Act has forced important readjustments in investment banking. As a result of the liability provisions, the tendency, whenever possible, is to spread the risk. Where formerly one banker might have taken charge of an issue, it now customarily originates in a number of houses. It has also become usual for the purchasing bankers to include "hedge clauses" in their contracts with the issuing corporation, reserving the right to cancel public offerings of securities when conditions justify. Thus, investment

bankers seek safeguards against the hazards of changing markets and the additional uncertainties provided by stop orders and twenty-day cooling periods.

Trading accounts to peg the price of securities in the course of distribution seem to be less used though they have not been abandoned. The Securities Exchange Act of 1934, however, discourages their employment since the S.E.C. reserves the right to impose penalties where they are used for manipulative purposes. Underwriting and distribution spreads are matters of public information and become subject to criticism if deemed excessive.

In general, investment bankers have fared poorly in the period since the passage of the Securities Act. The demand for the services of the investment banker has declined and underwriting and distributing spreads have been reduced. To an increasing degree, industry has been meeting its capital requirements from internal sources, from depreciation and depletion reserves, and from retained profits. In borrowing new money, large corporations have frequently turned directly to large institutional investors such as insurance companies and savings banks, and have by-passed both the investment bankers and the Securities Act. Since under this system of private placement there is no *public* offering of securities, the registration and liability provisions of the Securities Act do not apply. At the same time, investment bankers have lost lucrative business. In 1938 more than 37 per cent of all corporate bonds and notes issued were privately placed. As opportunities to float new issues became rarer, competition for the business that remained was intensified and the pressure to reduce underwriting and distributing spreads increased. In these circumstances, there was a natural disposition to identify grievances with restrictive legislation and to forget the malpractices which the Securities Act attempted to correct.

If, however, the Securities Act be judged in terms broader than its immediate effect on the profit prospects of investment bankers, certain positive accomplishments must be credited to it. The Act, to be sure, does not guarantee investors against losses. It does not prevent the issuance of securities of poor quality and in excessive amount. But it does ensure that investors shall receive truthful and adequate information and shall have the opportunity to exercise intelligent judgment based upon such facts. This is a very considerable step forward. For the first time, the affairs of corporate enterprise and the complexities of investment underwriting are fully ex-

posed to the light of day. The information made available by the Commission is carefully scanned by professional investment services and publicized in the financial press. The fraudulent promoter hesitates to expose himself to the scrutiny of the Commission and finds large-scale operations difficult. The Commission's careful examination of registration statements has its repercussions in the business world, in the form of improved accounting practices and higher standards of corporate administration. In this sense, the Securities Act provides ultimate protection for investors by pointing the way to a healthier corporate economy.

4. Regulation of the Securities Exchanges

The Securities Exchange Act of 1934 is designed to accomplish three major purposes: (1) "to make available currently to the investing public information regarding the affairs of the corporations whose securities are traded in the securities markets"; (2) "to prevent the diversion into security transactions of a disproportionate amount of the nation's credit resources"; and (3) "to eliminate manipulation and other abuses in the security markets." [16] To carry out the first purpose, the Act requires the registration of all securities traded on national exchanges, as well as registration of the exchanges themselves. To carry out the second, the Federal Reserve Board is given power to set margin requirements and the Securities and Exchange Commission is authorized to restrict borrowing by members of exchanges, brokers, and dealers. To carry out the third, the Act proscribes a large number of manipulative practices and vests the Commission with power to check their use. Willful violation of the Act is made a crime punishable by a fine of not more than $10,000 or imprisonment for not more than two years, or both.[17] Persons engaging in manipulative practices can be sued for damages by those who have suffered from such practices.

In order to eliminate manipulative operations by corporate "insiders," all directors, officers, and owners of 10 per cent or more of a registered "equity security" are required to file a monthly statement of transactions in the securities of their own company and are made ineligible to retain profits made on such transactions where the securities are held for a period of six months or less. In order to

[16] *Fifth Annual Report* of the S.E.C., 1939 (1940), p. 35.

[17] If the violator is an exchange, the fine may be $500,000.

recover such profits for the corporation, suits must be initiated by stockholders within a two-year period after the profits are realized. In addition, the Commission is vested with broad power to suspend or withdraw the registration of a securities exchange or of particular securities listed on exchanges. It may also suspend or expel members and deny or revoke the registration of a broker or dealer engaged in over-the-counter trading. The Commission may also impose trading rules on an Exchange, if the Commission deems changes necessary and the Exchange refuses to effect the desired changes.

Before considering the use which has been made of these broad powers, an examination of the organization of the New York Stock Exchange as it existed at the time of the passage of the Act may illuminate the problems which faced the Commission. The New York Stock Exchange, which accounts for over 80 per cent of the dollar turnover in stock on all exchanges in the country, is organized as a purely voluntary association. It has a constitution and bylaws, but it holds no charter from the state, and until the Securities Exchange Act was passed it was subject only to internal regulation. Its membership was, and is, limited. By February, 1929, there were 1,100 members; in that month the number of seats was increased to 1,375.[18] Memberships are bought and sold,[19] but no member can be admitted without the consent of the Committee on Admissions. A classification of the Stock Exchange membership according to primary functions as of October 1, 1935, revealed that of the 1,375 members, 391 were primarily commission brokers, 158 were primarily floor brokers, 35 were floor traders, 25 were odd lot dealers, 115 were odd lot brokers, 76 were bond brokers and dealers, 348 were specialists, and 227 were classed as inactive members.

The commission brokers, who remain numerically the largest group on the Stock Exchange, are engaged primarily in the business of executing transactions for the public. They may trade for their own account, but they depend mostly on commissions from customer trading to make their money. They are interested in a busy, active market, in which the public participates, rather than in their own personal speculation. Since they have direct relations with customers, they are sensitive to outside opinion. To the extent that they do not indulge in market manipulation they are less fearful of reg-

[18] Each member received a right to one quarter of one new membership.

[19] Prices ranged from over $500,000 in 1929 to less than $40,000 in recent years.

ulation and more ready to work with regulatory authorities. Such co-operation as the S.E.C. has had in Wall Street has come largely from within this group.

Opposition to stock exchange control has been most intense among the floor traders. The floor traders are engaged in the business of buying and selling securities for their own accounts on the floor of the Exchange. They have no contact with the public and need not be concerned about retaining customer good will. Since they trade directly on the floor, they are in a position to move quickly to take advantage of changing price trends. As inside professional speculators, they fear that regulation will curtail their activity and are consequently hostile, on the whole, to an extension of S.E.C. control.

Besides the commission broker and the floor trader, there are other groups of members whose attitude toward regulation cannot be classified so easily. The floor brokers (or $2 brokers, as they are called) make their money, in part, by executing orders for other exchange members, particularly commission brokers. Since they depend on commission brokers for business, they are influenced by the attitude of commission brokers toward regulation. But floor brokers may also trade on their own accounts, and thus find themselves in a position of divided allegiance.

The odd lot dealer, as his name implies, buys and sells securities in amounts less than the unit of trading prevailing on the Exchange. He derives his profit by selling to odd lot customers at one-eighth point above the market and buying from them at one-eighth point below the market. The transactions of the odd lot dealer are executed on the Exchange by the odd lot broker, who receives a commission for his services and may also trade on his own account. To the extent, however, that odd lot dealers and brokers are dependent on customer good will, they find themselves in a position similar to that of the commission brokers. Bond brokers and dealers specialize in bond transactions. The exchange market in bonds is less important than in stocks, and a large portion of bond transactions is accounted for by purchases and sales in the over-the-counter market, that is, off the Exchange.

The specialists constitute the second largest group on the Exchange. The specialist characteristically combines the function of both broker and trader. As a broker, he effects transactions for the accounts of other members or their customers in the particular

stock in which he is registered as a specialist. As a trader, he deals for his own account. In contrast with other members of the Exchange who move about freely on the floor, the specialist is stationed at a fixed point on the floor where his stock is regularly traded. Every major stock dealt in on the New York Stock Exchange has at least one specialist. The specialist ordinarily handles all the orders to buy and sell in the stock above or below the moment's market price. He is required to keep a book in which these orders are recorded. The book may give him certain advantages, since he has inside information about supply and demand, factors which affect the future price trend in his stock. Conceivably he may turn this special knowledge to his personal profit by trading in the stock on his own account. He, too, finds himself in a position of divided loyalty; to the extent that he looks to profit in trading rather than in commissions, he finds himself pulled toward the floor trader; to the extent that he depends upon commissions, he may be influenced by the views of the commission brokers.

Until the reorganization of 1938, the government of the Stock Exchange was entrusted to a Governing Committee chosen from within the Exchange. The Governing Committee and its subordinate committees prescribed the rules under which the Exchange operated. It could try members for violations of those rules; it had the power to fine, suspend, or expel those whom it found guilty. At the end of 1934 the Governing Committee included fourteen governors who represented commission houses and twenty-six members representing floor traders, specialists, and odd lot dealers. This meant that the government of the Exchange was controlled by "inside" speculative elements rather than by those doing business with and for the public. Although commission houses and their allies controlled more than a majority of seats on the Exchange, the nomination and election machinery was so arranged as to result in the perpetuation of the "in" group. Commission brokers complained of underrepresentation and claimed that the rules of the Exchange favored the floor trader and specialist. Thus, internal disaffection contributed to the movement for reorganization.

Under its first chairman, Joseph P. Kennedy, the S.E.C. moved slowly. Kennedy had no specific plans for fundamental reorganization of the Exchange; he believed that there were abuses to be remedied but, as far as possible, he expected the Stock Exchange to do its own house cleaning and its own policing. He hoped that it

would not be necessary for the S.E.C. to impose rules. Rules would be worked out in consultation with the Exchange, adopted by the Exchange as its own, and be self-enforced.

Under Kennedy the Commission set to work to carry out this program of self-regulation. Kennedy had been a successful Wall Street trader and enjoyed the confidence of the trading element in the Street. He encountered little difficulty in persuading the New York Stock Exchange to register under the Act. Other exchanges quickly followed. The next step was the problem of working out trading regulations for the Exchange. Here the Commission carried out the Kennedy program of self-regulation by negotiating with the Exchange, consulting it, and finally persuading it to adopt sixteen trading rules, designed to check manipulative practices.[20] Some of these rules were so general as to be relatively meaningless. Others merely codified rules which had already been adopted earlier by the Exchange. Still others, if followed faithfully, would have done much to discourage excessive trading and to establish a parity of advantage between member traders and buyers and sellers of stock who were part of the outside public. The effectiveness of these rules depended on the extent to which the Exchange, or dominant group on the Exchange, was interested in a strict program of enforcement.

With the adoption of these rules, Kennedy, who had agreed to serve as a member of the Commission only until it was well launched, felt that his task was accomplished and resigned. James M. Landis was named Chairman to succeed Kennedy. Under Chairman Landis the Commission perfected machinery for detecting stock manipulation, but still hesitated to impose rules on the Exchange. The stock ticker tape was kept under constant surveillance. Suspicious activity in particular stocks was investigated; cases where discipline of Stock Exchange members seemed to be called for were brought to the attention of the Exchange. But the leniency of the Stock Exchange's Committee on Business Conduct and its reluctance to impose severe punishment on violators of its trading rules finally forced the Commission to the conclusion that the time had come for more stringent regulation.

Signs of a stiffening of attitude on the part of the Commission began to be evident. In February, 1937, "free rides" for brokerage

[20] The rules are reprinted in Appendix I, *First Annual Report* of the S.E.C. (1935), pp. 40–44.

house customers were eliminated at the suggestion of the S.E.C. and the Federal Reserve Board. This move was aimed at customers who, instead of putting up margin when called upon, took full advantage of the three-day grace period and then lightened their commitments in order to evade the margin requirements. The Stock Exchange was forced to amend its rules to provide that its member traders and their partners must be fully margined at all times. This provision was designed to discourage excessive trading. Specialist rules were stiffened. Specialists, under the new rule, had to be in a position to prove that every transaction for their own accounts met tests of "reasonable necessity." In August, 1937, the S.E.C., dissatisfied with the wrist-slapping punishment meted out by the Exchange for violation of trading rules, went into action itself and ordered that Mike Meehan, one of the important speculators on the Exchange, be expelled from membership on national securities exchanges for manipulation in Bellanca stock. After the collapse of the market in September and October, 1937, and an investigation which revealed that the decline had been accentuated by short selling on the part of members of the Exchange, the Commission in January, 1938, announced new rules to regulate short selling.[21] These determined efforts to stiffen the rules of trading and to punish manipulation were attended by increasing signs of friction between the S.E.C. and the Stock Exchange.

After Landis's departure in September, 1937, to become Dean of the Harvard Law School, William O. Douglas was named Chairman of the Commission. He promptly called for reorganization of Exchange administration. In a fighting speech on November 23, 1937, he warned that "the time is past when the country's exchanges can be operated as private clubs." He suggested that "there would be greater public confidence in exchanges (and the prices made thereon) which recognized that their management should not be in the hands of professional traders but in fact, as well as nominally, in charge of those who have a clearer public responsibility." While recognizing that the Commission's burden of regulation would be

[21] These rules provided that short sales must be made at a price one-eighth point above the preceding sale. Subsequently, on recommendation of the Stock Exchange, the rules were modified to permit short sales at the price of the last sale, provided that the last sale price was itself higher than the last different price which preceded it. For the purpose of interpreting these rules, a short sale was defined to mean "any sale of a security which the seller does not own or any sale which is consummated by the delivery of a security borrowed by, or for, the account of the seller."

eased if it could operate through existing exchange machinery, he professed little confidence in the willingness of the "Old Guard" on the Exchange to police and discipline violations of trading rules. This speech met a sympathetic response from the underrepresented commission broker bloc within the Exchange, and the pressure for action became intense.

Late in 1937 the President of the Exchange appointed a committee of nine, headed by Carle C. Conway, to report on the advisability of Exchange reorganization. The Conway report, which was submitted early in 1938, began with this statement:

Our approach to the question of the Board of Governors is designed to effect adequate representation of members and partners who come into daily contact with the public, plus the addition of public representatives. We believe that the admission to the Board of substantially increased representation from points outside of New York will be of distinct advantage to the Exchange in endowing its policy with a national viewpoint.

It was suggested that governors be ineligible to succeed themselves after two consecutive three-year terms, in order "to end the criticism that the Stock Exchange is run by a self-perpetuating group." The report proposed a Board of Governors of thirty-two members of whom the Chairman of the Board and the President would be members ex-officio; of the remaining thirty members, fifteen were to be members of the New York Stock Exchange, chosen with due regard to the various interests represented in the membership, six were to be nonmember partners of New York member houses to be chosen from firms doing either a stock or a bond business for the public, six were to be nonmember or member partners of firms doing a stock or bond business for the public but having their principal place of business outside New York City, and three were to be representatives of the public nominated by the President. The nominating committee of seven was to be composed of four members of the Exchange, chosen to reflect the various interests of the Exchange, two nonmember partners of New York member firms, and one member or partner from an out-of-town member firm. The report also provided for a full-time, salaried President, who was to be selected by the Board of Governors to serve as chief executive officer of the Exchange and as its representative in all public matters. The President was to serve at the pleasure of the Board.

In spite of "Old Guard" dissatisfaction with the report, it was

put in the form of constitutional amendments for submission to the membership. Just before the vote there occurred a dramatic event—the arrest of Richard Whitney, former "Old Guard" President of the Exchange, for grand larceny. The Whitney scandal ensured the complete collapse of "Old Guard" opposition. The Conway report was endorsed and the "reformers" in the Stock Exchange named the new Board of Governors. William McChesney Martin, Jr., who had been a leader in the reform movement, was selected as the first President of the reorganized Exchange.

With the triumph of the "reformers" a new era of co-operation between the S.E.C. and the Exchange began. A series of round-table discussions was held to work out new trading rules. The Whitney case had revealed the inadequacy of existing rules of the Exchange to protect customers' funds and securities.[22] As a consequence of the Whitney investigation, the Board of Governors of the Stock Exchange announced, on October 23, 1938, the adoption of a thirteen-point program of safeguards which was to be put into effect as soon as possible.[23]

Under this program member firms were to be encouraged to organize "affiliated companies," which would carry on dealer and underwriting activities separately from their brokerage activities. An annual audit, by independent accountants, of all member firms doing business with the public was to be required. Provision was to be made for an increase in the number of members' periodic financial statements and in the frequency of the Exchange's surprise examinations of its member firms and partners. The minimum capital required of member firms was to be increased, and methods were to be studied by which customers might be insulated against the risks incident to the dealer business conducted by many brokerage firms. All loans by and between officials of the Exchange and its members were to be prohibited, and all members, member firms, and partners were to be required to report to the Exchange all substantial loans. Members of brokerage firms doing business with the public were not to be permitted to trade in securities on margin.

[22] "For at least 3½ years prior to its collapse, Richard Whitney and Company had done business as a member firm while insolvent. Richard Whitney's own misappropriation of customers' securities had commenced as far back as 1926, and, subsequent to 1936, had continued undetected as a regular practice." See *Fifth Annual Report* of the S.E.C., 1939 (1940), p. 36.

[23] *Ibid.*, see pp. 39 and 262–265 for summary.

Weekly information as to underwriting positions was to be filed with the Exchange. The Exchange also undertook to study a proposal for the establishment of a central securities depository, or "Brokerage Bank," where customers' credit balances and securities could be placed for safekeeping and protected from the hazards of brokerage insolvency. Much of this program has since been embodied in rules of the Stock Exchange.

Meanwhile, the S.E.C. has been continuing its policy of encouraging self-policing and self-reform by the Stock Exchange instead of intervening directly and issuing rules and regulations under its statutory powers.[24] Co-operation of the new leadership in the Stock Exchange with the S.E.C. is fostered by frequent round-table conferences as new problems present themselves. But the primary goal

[24] The policy of encouraging self-discipline instead of taking direct remedial steps has recently been illustrated by the Commission's conclusions with reference to the auditing procedure followed by Price, Waterhouse and Co. in the *McKesson and Robbins* case. After criticizing Price, Waterhouse and Co. for certifying registration statements and annual reports which contained false and misleading information, the Commission continued:

". . . The time has long passed, if it ever existed, when the basis of an audit was restricted to the material appearing in the books and records. For many years accountants have in regularly applied procedures gone outside the records to establish the actual existence of assets and liabilities by physical inspection or independent confirmation. As pointed out repeatedly in this report, there are many ways in which this can be extended. Particularly, it is our opinion that auditing procedures relating to the inspection of inventories and confirmation of receivables, which, prior to our hearings, had been considered optional steps, should, in accordance with the resolutions already adopted by the various accounting societies, be accepted as normal auditing procedures in connection with the presentation of comprehensive and dependable financial statements to investors.

"We have carefully considered the desirability of specific rules and regulations governing the auditing steps to be performed by accountants in certifying financial statements to be filed with us. Action has already been taken by the accounting profession adopting certain of the auditing procedures considered in this case. We have no reason to believe at this time that these extensions will not be maintained or that further extensions of auditing procedures along the lines suggested in this report will not be made. Further, the adoption of the specific recommendations made in this report as to the type of disclosure to be made in the accountant's certificate and as to the election of accountants by stockholders should insure that acceptable standards of auditing procedure will be observed, that specific deviations therefrom may be considered in the particular instances in which they arise, and that accountants will be more independent of management. Until experience should prove the contrary, we feel that this program is preferable to its alternative—the detailed prescription of the scope of and procedures to be followed in the audit for the various types of issuers of securities who file statements with us—and will allow for further consideration of

remains that of protecting the investing public, and if the exchanges prove unable or unwilling to provide such protection through their own disciplinary machinery, the residual statutory powers of the Commission remain ready to be invoked.

5. Regulation of the Over-the-counter Markets

The over-the-counter markets embrace all transactions in securities which do not take place upon an organized exchange. The brokers and dealers who make it their business to provide facilities for these transactions may be said to make up the over-the-counter market. Many securities are not traded on the exchanges, and can only be bought and sold through dealers and brokers who specialize in making a market for such securities. In other cases, where securities are listed on exchanges, there may still be advantages in arranging transactions "off the board." [25] Of the 6,766 firms of brokers and dealers registered with the Commission in 1938 and transacting over-the-counter business, only 1,371 were members of an exchange.

The Securities Exchange Act of 1934 empowered the Commission to regulate the over-the-counter markets, in order, as the Senate Committee on Banking and Currency put it, "to forestall the widespread evasion of stock exchange regulation by the withdrawal of securities from listing on exchanges, and by transferring trading therein to over-the-counter markets where manipulative evils could continue to flourish, unchecked by any regulatory authority." The Act provided for registration of brokers and dealers in over-the-counter markets and for supervision of their transactions. The Commission at first moved slowly, but after study and some experience, in 1936 the Act was amended in specific language to outlaw manipulation. In January, 1936, rules were adopted requiring full disclosure of information concerning the terms of over-the-counter transactions, and in August, 1937, the Commission issued rules defining manipulative, deceptive, and fraudulent practices.[26]

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varying audit procedures and for the development of different treatment for specific types of issuers."

See *Summary of Findings and Conclusions, In the Matter of McKesson & Robbins, Inc.*, S.E.C., December 5, 1940, pp. 11–12.

[25] Thus, large transactions may be arranged in the over-the-counter markets quickly, quietly, and without disturbing price movements.

[26] For a summary of these rules see R. L. Weissman, *The New Wall Street* (1939), pp. 181–183.

But the task of policing the over-the-counter markets by direct regulation would have involved large expenditures and heavy increases in personnel for the Commission. In order to avoid this burden, the Commission suggested that the pattern of self-regulation which had already been applied to the exchanges be expanded to include the over-the-counter markets.

The Maloney Act, which was enacted in 1938, provided for the formation and registration of one or more voluntary associations of investment bankers, brokers, or dealers doing business in the over-the-counter markets. These associations were to adopt rules of fair trade practices and to exercise disciplinary powers over their members. The S.E.C. was vested with residual power over the activities of the association. While membership in such an association is technically voluntary, the fact that nonmembers may be barred from obtaining brokers' discounts provides a powerful compulsion to join. On August 7, 1939, the application of the National Association of Securities Dealers, Inc. (embracing almost all of the major investment bankers and over-the-counter brokers and dealers in the country) for registration as a national securities association was granted.[27] With this action, the S.E.C. was launched on another experiment in self-regulation, the full significance of which cannot yet be appraised. The over-the-counter markets, however, have a powerful incentive to co-operate. With the exchanges anxious to obtain business at the expense of the over-the-counter markets, and aggrieved at the more stringent requirements imposed on listed securities as compared with unregistered securities traded in over-the-counter markets, the pressure on the latter to meet the challenge of self-discipline is very great.

6. Other Regulatory Activities of the S.E.C.

CORPORATE REORGANIZATIONS

Chapter Ten of the Bankruptcy Act as amended in 1938 [28] imposes new duties on the Commission with reference to corporate reorgan-

[27] See 5 S.E C. 627.

[28] These amendments, known as the Chandler Act, constitute a general revision of the entire Bankruptcy Act of 1898, as amended, with the exception of those provisions which relate to railroad reorganizations, municipal debt readjustments and extensions, and compositions of agricultural debts. Chapter Ten, dealing with corporate reorganization, replaces the former Section 77B of the Bankruptcy Act.

izations in federal courts. The Act provides, first, that the Commission shall participate as a party-in-interest in corporate reorganizations at the request of the court, or on its own motion, if approved by the court. By giving the Commission a right to be heard on all matters arising in the proceeding, the Act makes independent, expert advice available both to the courts and to investors. In the second place, the Commission is also empowered to prepare advisory reports on plans of reorganization which may be submitted in such proceedings. Where the total indebtedness of the debtor does not exceed $3,000,000, a federal court *may,* and where the indebtedness exceeds $3,000,000, a federal court *must,* submit reorganization plans to the S.E.C. for examination and report. On the approval of any plan by the judge, the Commission's report must be transmitted to creditors and stockholders who are being asked to vote on the plan.

As this summary indicates, the Commission has no authority under the Chandler Act to veto or require the adoption of a reorganization plan, or to settle any of the issues which arise in the course of the proceeding. Its functions are purely advisory. The investigating facilities of the Commission are at the disposal of the courts and investors. If effectively utilized the reports of the Commission may go far to ensure that the assets of corporations in reorganization are preserved, and that reorganization plans provide sound corporate structures and fair and equitable treatment for different classes of security holders.

THE TRUST INDENTURE ACT OF 1939

The enactment of the Trust Indenture Act of 1939 represents another extension of the frontiers of investor protection. Trust indentures are legal instruments by which an equitable right or interest in property is conveyed to a trustee and in accordance with which the trustee may be required to protect the interests of investors who are the beneficiaries of the trust. Investigation by the S.E.C. in 1936 [29] revealed numerous instances where trustees under indenture had failed to protect the interests of security holders. In some cases trustees under indenture were found to be occupying

[29] See S.E.C., *Report on the Study and Investigation of the Work, Activities, Personnel, and Functions of Protective and Reorganization Committees,* Part VI, *Trustees Under Indentures* (1936). This study was authorized by the Securities Exchange Act of 1934.

other positions which involved them in conflicts of interest with the security holders to whom they were ostensibly responsible under the terms of the indenture.

The Trust Indenture Act of 1939 is designed to eliminate these evils. It vests the S.E.C. with power to regulate the practices, operations, and security transactions of trustees under indenture. The primary objective of the Act is to impose upon indenture trustees the standards of fiduciary responsibility which have long obtained in the administration of personal trusts. While the Act has yet to be tested by experience, it sets up important barriers against exploitation of investors and promises to make indenture trustees active guardians of investment in the corporate field.

THE INVESTMENT COMPANY AND INVESTMENT ADVISERS ACT OF 1940

As a result of catastrophic losses suffered by many investors in investment trust securities, Congress in 1935 authorized the S.E.C. to undertake an investigation of investment trusts and to bring in recommendations for legislation. The present law is an outgrowth of this investigation.

The investigation itself is a record of a sorry chapter in American finance.[30] The attraction of the investment trust was its promise of safety through diversification of risk and expert management in selection of the securities in the trust's portfolio. In numerous cases these advantages were and continue to be realized. In other instances, also widespread, they were unfortunately not realized. With respect to twenty-two investment companies which had become bankrupt, the S.E.C. estimated that up to December 31, 1935, security holders had sustained a capital loss of approximately $510,000,000 out of a total net capital contribution of almost $560,000,000.[31] In some instances, there was outright looting of assets by unscrupulous promoters or groups who managed to capture control. In others, the companies were operated to serve the interests of the sponsors rather than the best interests of the investors. Complicated capital structures were ofttimes devised which gave the promoters control without any substantial investment of their own funds. Self-dealing was rampant. Boards of directors often consisted of representatives of banking, brokerage, or distributor sponsors who

[30] See S.E.C., *Investment Trusts and Investment Companies* (1939, 1940).

[31] *Hearings*, Subcommittee of Senate Committee on Banking and Currency, 76th Cong., 3rd Sess., on S. 3580, Part I, p. 34.

used the investment trusts as instruments of speculation, as dumping grounds for dubious securities, or as means of multiplying brokerage and selling commissions to themselves. "Insiders" utilized investment trust funds to make loans to themselves, to give themselves long-term management contracts, to finance companies in which they were personally interested, and to obtain control of other enterprises. In order to eliminate these and other abuses, Congress enacted the Investment Company and Investment Advisers Act of 1940.

The major provisions and objectives of the law can be summarized briefly. Publicity is ensured through a requirement that investment companies register with the S.E.C. In order to discourage self-dealing, at least 40 per cent of the directors of the investment trust are required to be independent of principal underwriters, regular brokers, managers, or advisers. Transactions with affiliated persons and underwriters are subject to regulation by the S.E.C. The Commission is vested with power to supervise mergers, consolidations, and reorganizations of investment companies, and to ensure equitable distribution of voting power among different classes of securities. Management and underwriting contacts and major changes in investment policy must be approved by a majority of voting security holders. Sources of dividends must be revealed. Speculative practices such as buying on margin and short selling are forbidden. Rigid provisions are made for adequate accounting records and an independent audit.

The Act also requires that investment advisers register with the S.E.C. Registered investment advisers may not make any profit-sharing arrangements with their clients, nor may they assign contracts with clients to others without the consent of the client. They are also prohibited from employing any scheme, device, or artifice to defraud a client. If an investment adviser acts as a principal for his own account in a security transaction with a client, he is required to disclose to the client the capacity in which he is acting and obtain the consent of the client to such transaction. Willful violation of the Act is punishable by a fine of $10,000 or not more than two years' imprisonment, or both.

It is still too early to measure the effect of this legislation. Whether the benefits which it seeks to achieve will accrue, will depend upon the skill with which it is administered. The well-managed investment trust clearly has an important function to

perform, both for investors and for American business. The Act seeks to preserve the advantages of this type of investment while making it difficult for such trusts to engage in activities detrimental to the investor. Reputable investment companies and advisers, as well as investors, can only endorse these objectives.

7. Conclusion

As this review of recent legislation indicates, the S.E.C. has been vested with broad administrative responsibilities to protect the interests of investors. Its wide-ranging authority gives it power to regulate the practices of the security markets, to shape the standards of corporate finance, and to affect, if not to direct, the flow of investment into new enterprise.

Allegations that overregulation by the S.E.C. has proved harmful to business and finance have frequently been made. Requirements for the registration of securities have been condemned as unnecessarily complex and expensive. Twenty-day cooling periods and stop orders have been criticized as creating undesirable delays and serious hazards in the flotation of security issues under rapidly changing market conditions. Security market controls have been held responsible for thin markets and unprofitable brokerage and dealer operations. Burdensome S.E.C. restrictions have been pointed to as irritants which have tended to paralyze new investment. Defenders of the Commission have tended to deny that these criticisms are justified. They have insisted that restrictions are essential if the interests of investors are to be protected, and they have stressed the fact that the Commission has simplified its requirements and relaxed its regulations where clear burdens could be demonstrated.[32]

The resentment which the activities of the S.E.C. have generated in some business and financial circles has undoubtedly been accentuated by the rapidity and sweep of the transformation which New Deal financial controls have worked. Yesterday's freedom from regulation has given way to restrictions which limit substantially traditional managerial prerogatives. Swift business adjustment to

[32] See, e. g., Securities Act of 1933, Release No. 2340, August 23, 1940, for an exposition of the Commission's policy with respect to acceleration of the effective date of registration statements. Discretionary authority to modify the twenty-day cooling period was conferred on the Commission by a 1940 amendment to the Securities Act of 1933.

the new controls presents its psychological as well as economic difficulties, even though it is recognized that legitimate business and financial concerns have cause to be grateful when the crooked and shady are driven to cover.

As a result of the disclosure of past abuses and the pressure of injured investors, the trend of public policy since 1933 clearly has been in the direction of providing additional safeguards for the savings of small investors. Efforts have been made to discourage excessive speculation and to eliminate the advantages of the "insider." The acts under which the S.E.C. operates and the administrative content which is being poured into them look forward to a corporate economy with high fiduciary standards, a financial structure based upon real values, and an exchange so operated that the informed investor is protected against extreme and unwarranted fluctuations in the value of his securities. This need not mean that investment is discouraged or speculation made impossible. The object is rather to establish a parity of advantage among all those making investment decisions and to provide for the buying public the basic information for sound choices.

Chapter Thirteen. ANTITRUST LEGISLATION AND THE ATTACK ON MONOPOLY

In the course of the past half century, American public policy in industrial regulation has developed two well-defined traditions. The economy has been divided for regulatory purposes between public utilities on the one hand and the rest of business on the other. For the former, a substantial and expanding group, positive regulation by special public agency has become an almost universally accepted policy.[1] For the latter, competition has been viewed as the most effective regulator in the public interest. The rapid industrialization of the country in the decades following the Civil War brought in its train insistent and successful efforts among entrepreneurs toward combination and consolidation, sometimes approaching monopoly. As a result, the organized pressures of disadvantaged competitors and agricultural consumers, together with the response of unorganized consumers to vote-stimulating, antimonopoly activity by office seekers, produced a peculiarly characteristic American policy, unique among the major nations of the world. Competition was to be maintained and made fair by law. To this end, the judicial process would be set in motion at the instance of the public prosecutor. Nation-wide acceptance of this policy was signalized by the passage in 1890 of the federal Sherman Antitrust Act.

[1] The alternative policy of government ownership and operation is treated in Chapters 18 and 19.

1. The Combination Movement

The period between the close of the Civil War and the turn of the century witnessed a complete transformation of American economic life. The phenomenal growth of the railway network fused a congeries of local markets into a single market of nation-wide extent, and made possible for the first time the development of mass production and mass sales techniques and of large-scale corporate enterprises in their modern form. An increasing proportion of a rapidly increasing population was being urbanized, much of it employed in newly erected factories. Meanwhile, the typical scale of business enterprise was being enlarged. As little business became big business, it altered its form of organization and legal dress. Individual enterprise and the partnership gave way to the corporation.

This era of industrial expansion was characterized by two closely related developments of fundamental importance, which are still in progress at the present day. The first was a natural corollary of the growing scale of enterprise, with its many marked economies; it took the form of increased concentration of production in the hands of a limited number of firms. In many fields this tendency left competition virtually unimpaired, but in others particular enterprises came to dominate a sufficient proportion of the market to give them substantial control over the pricing of their commodities. Secondly, and of greater significance from the viewpoint of public policy, there developed a marked trend toward conscious and positive co-operation among businessmen in order to limit competition and achieve effective control of their markets through consolidation, combination, or agreement. It was this latter movement which constituted the so-called "trust problem," a problem as yet unsolved.

The combination movement, as distinguished from the movement toward large-scale enterprise, has developed continually from the close of the Civil War to the present, but with particular intensity in three phases. The first, covering the period from 1879 to 1893, included the formation of the celebrated "trusts proper" and produced the first wave of antimonopoly legislation, both state and federal. Giant mergers in the form of holding companies or outright consolidations, created on the initiative of professional promoters, characterized the second phase, lasting from 1897 to 1903. The third intensive phase, from 1922 to 1929, utilized the forms of

the second for relatively new industries, including electrical utilities, motion pictures, radio, and automobiles. It witnessed, in addition, a strong movement for market control through trade associations, a movement which culminated in the passage of the National Industrial Recovery Act of 1933.

A number of impelling causes motivated the first phase. The revolution in methods and costs of transportation destroyed a multitude of local semimonopolies, expanding the typical market from a single state or region to the entire country. The entrepreneur could no longer depend upon his own territory for an assured core of demand, which permitted him to extend his efforts elsewhere at his leisure. The products of a distant rival might now easily be brought to consumers at the very doorstep of his factory. At the same time, the increasing importance of fixed capital equipment in many industries, a result of technological change, with the concomitant increase in the proportion of overhead to variable costs, fostered competition of the "ruinous" or "cutthroat" variety with prices remaining below total costs for long periods of time. Railway rate wars were only the most outstanding example of this tendency, which was enhanced by the general trend toward falling prices between 1867 and 1895. Under these circumstances it is not surprising that businessmen frequently sought to "stabilize" their markets by agreement. Again, a single man or group of men, like Rockefeller and his associates in the Standard Oil Company, would foresee the economic advantages to be derived from control over output and price, to say nothing of personal power and social prestige in America's "Gilded Age," and would pursue an aggressive policy of consolidation by both persuasive and predatory methods. Success and monopoly profits in one field stimulated emulation in others. While to some extent the movement was merely a by-product of attempts to achieve the economies of large-scale production, for the most part it had its roots in the desire to eliminate competition and enjoy monopoly profit.

THE FORMS OF COMBINATION

Combination among former competitors took many forms, ranging from the loose "gentlemen's agreement" to the complete merger of assets and corporate identities into a single firm. The most common type of agreement in the earlier period was the pool, the lineal predecessor of many modern trade associations and the Amer-

ican counterpart of the European cartel. Strictly used, the term refers only to agreements under which the output or income (or, in the case of railways, the traffic) of a number of firms is lumped together and redivided in agreed proportions, regardless of the quantities actually produced or earned by each. But the expression was commonly applied more broadly, to include any agreement among members of an industry on a common price policy, on limitation or sharing of output, on common use of patents, or on geographical allocation of markets. The more effective pools implemented their agreements with institutional machinery of one sort or another, which might enforce fines or other penalties for noncompliance; they also provided common services. Thus, the well-known Michigan Salt Association of 1876 served as a common and exclusive sales agency, assuring itself in this manner of control over the industry's prices and completely eliminating competition for customers.[2]

Pools won particular popularity with businessmen in the eighteen-eighties and nineties, when they were utilized in the coal, meat-packing, whiskey, wallpaper, bagging, cordage, and gunpowder industries, and in many branches of the iron and steel trade, including wire nails, steel rails, structural steel, and cast-iron pipe. They suffered, however, both from the adverse attitude of the common (and, later, also statute) law and from certain inherent defects. Increased prices due to a pool's action frequently tempted members to break away in secret from agreements upon restrictions of output. Excessive price rises sometimes stimulated independent competition or competition from substitute products to such an extent that the price structure was soon broken down to a point less profitable than that preceding the pool's formation. Thus, while the device of the pool in one form or another has been used continuously to the present day, many industrial leaders found it desirable to turn to closer and more effective forms of combination. Among these the most celebrated was the "Trust," devised by Standard Oil attorneys in 1879.

The "trust proper," which gave its popular name to the entire combination movement, involved a simple adaptation of an ancient legal device, widely used for other purposes, to the ends of unified control over a number of corporations. Owners of a majority of the common stock of each member company transferred their

[2] J. W. Jenks, "The Michigan Salt Association," 3 *Political Science Quarterly* 78–98 (March, 1888).

holdings, and therewith the controlling voting power, to a small board of "trustees." The owners received in return "trust certificates," entitling them to prorata shares in the various companies' distributed profits. In this way, the functions of supplying capital, receiving dividends, and bearing risk were completely divorced from that of control. Once consummated, the trust agreement ensured absolute and unqualified unity of policy among the members, determined by the all-powerful trustees who were now the legal owners. The first Standard Oil Trust, formed in 1879, utilized a "dummy" board of three minor employees; but it was found convenient in 1882 to rewrite the agreement, setting up as the new board the nine leaders of the Standard group, including John D. and William Rockefeller, O. H. Payne, H. M. Flagler, and John D. Archbold.

Free from the internal defects of pools, although of course still subject to independent competition, the Trust was widely used as a method of combination during the next few years. The whiskey trade, heretofore suffering from chronic overproduction and cutthroat competition, abandoned vain attempts at stabilization through pools in favor of the Distillers' and Cattle Feeders' Trust (1887). The cottonseed oil, linseed oil, white lead, sugar refining, carbon filament, and fruit preserving industries were all similarly organized during the same decade. An official report in 1888 declared that "this form of combination was obviously devised for the purpose of relieving the trusts and trustees from the charge of any breach of the conspiracy laws of the various States, or of being a combination to regulate or control the price or production of any commodity," and that "all trade combinations having similar aims either have adopted this method or speedily will do so." [3] The common law, however, supplemented by a host of unfriendly legislative measures, soon put an end to the use of this device.

Having served its purpose in pointing the way toward increasing effectiveness in industrial combination, and having become identified in the public mind and press with every predatory practice indulged in by any type of big business, the trust proper disappeared from the American scene. From 1892 on, the combination movement diverged along two fairly well-defined lines. The first, and relatively less important, continued to employ the informal and

[3] House Committee on Manufactures, *Report on Investigation of Trusts,* H. Rept. 3112, 50th Cong., 1st Sess., p. ii.

necessarily secret pool. The second, which formed in the years 1898 to 1902 the culmination of the entire movement, wore the legal dress either of the holding company or of outright merger into a single firm.

Outright merger, logically the simplest form of combination, requires little comment. It was utilized extensively during the entire period under review, as the most efficient size of enterprise expanded. The Standard Oil Company bought up innumerable refineries from 1872 on, generally by exchanging Standard stock for the securities of the independents and canceling the latter. As a method of dominating entire large industries, however, this device sometimes proved impracticable. It required the consent of each class of security holder in the transferred companies and involved highly complex negotiations on proper terms of exchange. The holding company, a corporation controlling other corporations by the ownership of a majority [4] of their common stock, was equally effective as a means of market control and was much easier to form. Moreover, by pyramiding successive layers of holding companies one on another, a few entrepreneurs with a relatively small investment could dominate the policies of operating companies representing a vast investment at the bottom.

Until 1888 the general incorporation laws of no state permitted companies to own stock in other companies, and a number of common-law decisions had forbidden such acquisitions without express legislative sanction. In that year the New Jersey legislature, at the instigation of New York lawyers anxious to find a new form through which to accomplish the purposes of the then threatened Trust, amended its law to permit unrestricted intercorporate stockholding. Several of the former Trusts, including Standard Oil and cottonseed oil, as well as a number of new combinations, proceeded to organize their activities in holding company form. The lucrative income from incorporation fees, which permitted the remission of less popular forms of taxation, tempted other states to follow New Jersey's example. So began the competitive race in "charter mongering," which to this day has always provided businessmen with at least one state in which they might incorporate without the restraints generally thought desirable elsewhere in the nation. Outstanding new holding companies appeared in the gunpowder, to-

[4] Where the bulk of the stock is widely distributed, ownership of as little as 20 or 30 per cent may often be sufficient to ensure effective control over corporation policy.

bacco, and meat industries. Head and shoulders above all others in respect to size was the United States Steel Corporation, organized in 1901. Large-scale mergers, on the other hand, were employed by the Diamond Match Company (1889), the American Tobacco Company (1890), the Distilling and Cattle Feeding Company (1890), the American Sugar Refining Company (1891), the International Paper Company (1898), the National Biscuit Company (1898), the United Shoe Machinery Corporation (1899), the American Can Company (1901), the Amalgamated Copper Company (1901), the International Harvester Company (1902), the E. I. Du Pont de Nemours Powder Company (1903), and many others. The bulk of the new combinations were incorporated in New Jersey.

This intensive second phase of the combination movement was brought to a close by a series of factors. In part, it resulted simply from the temporary exhaustion of new fields for the ingenuity of promoters. The stock market decline of 1903 made it difficult to float new issues on favorable terms. The movement was also discouraged by the failure of the United States Shipbuilding and International Mercantile Marine Companies in 1902–03, and by the dissolution in 1904, under the terms of the Sherman Act, of the Northern Securities Company, a New Jersey holding company in the railroad field. Public policy toward the "trusts,"[5] meanwhile, had undergone a marked development.

2. The Development of Public Policy

So thoroughgoing a transformation of America's economic life could not fail to evoke protective responses from groups adversely affected. A successful trust necessarily impeded free entry into the industry concerned, frequently by methods of dubious commercial morality. It thereby created enemies among outsiders jealously observing a profitable business. In so far as loss or the fear of loss is a more powerful stimulant to action than hope of gain, even more potent resentment was kindled in the hearts of those former competitors who felt themselves "frozen out" of the market, or bought out at figures below their own valuations, through the pressure of what they termed "unfair" competitive methods.

[5] The term "trust" is employed in this discussion in its common meaning of any large combination, whatever its organizational form, which dominates an industry. The "trust proper" will be referred to by the capitalized form "Trust."

Hardly less concerned were the primary producers of commodities purchased by trusts for further manufacture, like petroleum, grain (for whiskey), and cottonseed, for these producers were now deprived of the benefits of buyers' competition. These groups were quick to organize and press their interests at the various state capitals and in Washington. Nevertheless, however vociferous, they could not by themselves have created an effective antimonopoly movement. Their objectives were peculiarly favored by a widespread public psychology, which office seekers and legislators could not afford to ignore. That psychology feared these first foreshadowings of the emergent pattern of a new economic order, in which the old freedom of small enterprise seemed threatened with extinction and the lives of ordinary men with domination by corporate octopuses ruled by a private and secret oligarchy. Consumers of the necessaries of life would be at the mercy of the monopolies. Like the railroads, they were also feared as corrupters of the democratic processes of government itself. The antimonopolist writers of this period exhibited a moral fervor which is expressed today only very rarely. Henry Demarest Lloyd wrote of the destruction of our civilization by barbarian money-makers, "gluttons of luxury and power, rough, unsocialized, believing that mankind must be kept terrorized," who "claim a power without control, exercised through forms which make it secret, anonymous, and perpetual." [6]

Public sentiment against the combination movement was concentrated with particular severity upon the giants of the eighteen-eighties, above all on the Standard Oil and Sugar Trusts. The Standard Oil Company of Ohio, formed in 1870 by John D. Rockefeller and various associates, had campaigned systematically from its inception to gain control over the entire business of refining petroleum in this country. Domination of the channels of transportation was its prime instrument. First Cleveland, and later Philadelphia, Pittsburgh, New York, and other large refining centers were brought into the scheme, sometimes by peaceful purchase, sometimes by purchase under threat, and sometimes by purchase after a period of competition generally disastrous for the independent. An important agency of the Standard Oil group in this early period was the notorious South Improvement Company, which was organized by Standard to negotiate with the leading oil-carrying railroads for special favors. In return for a guaranteed division of its traffic

[6] *Wealth against Commonwealth* (1898), p. 510.

among the Pennsylvania, New York Central, and Erie Railroads in agreed proportions, this secret company not only received rebates of 40 to 50 per cent on listed freight rates for its own crude oil, and 25 to 45 per cent on refined, but also rebates of like amount on oil shipped by its competitors. Detailed reports of competitors' shipments were also supplied to the company. However reasonable this extraordinary arrangement may have been from the viewpoint of the carriers,[7] who were suffering from chronic rate wars and welcomed any device for stabilizing the division of traffic, it added an absolutely invincible competitive weapon to the economic efficiency of the Standard.

Despite the sworn secrecy of all participants in this scheme, news of it leaked out to the oil-producing regions of Pennsylvania and evoked the first organized opposition to Standard Oil. Harrisburg and Washington were besieged by good-sized lobbies and giant petitions for relief. A Producers' Protective Association sprang up to carry on the fight by boycotting the company. Legislative action to authorize independent pipe-line construction was forestalled by the influence of the Pennsylvania Railroad, but the South Improvement Company's charter was repealed and its contracts dissolved. Nonetheless, the Standard interests continued to receive rebates throughout the seventies, and with their aid the absorption of refineries continued apace. Pipe lines, the new means of oil transportation, were also monopolized by the Company. By 1879 it controlled 90 to 95 per cent of the country's refining capacity. Its last severe fight with the organized independents, who constructed the Tidewater pipe line in 1878 to supply their own refineries on the seaboard, was won in 1883, after a brief era of intense rivalry. By this time the Standard group had organized itself under the famous Trust Agreement of 1882. It had made a close approach to absolute monopoly.

The Sugar Trust arose with almost equal rapidity. During the early part of the decade of the eighteen-eighties, technical improvements in sugar refining had increased the most economical size of plant and had led to substantial overdevelopment of capacity. Failure of a number of refineries followed an era of cutthroat competition. To remedy this situation, H. O. Havemeyer organized in 1887 the Sugar Refineries Company, a Trust owning twenty refineries

[7] This viewpoint is strongly argued by G. H. Montague in *The Rise and Progress of the Standard Oil Company* (1903), p. 34.

and producing about 78 per cent of the country's capacity. Although heavily overcapitalized from the start, the company began to buy out and shut down the plants of remaining competitors at relatively high prices, recouping its losses through immediate increases in the price of refined sugar. Transformed in 1891 into the American Sugar Refining Company, a New Jersey corporation, it controlled by the following year 98 per cent of the industry. Its history during the next dozen years was a succession of periods of high prices in the absence of competitors, consequent stimulation of new competition, low prices and a campaign to acquire or destroy the competitors, and a repetition of the entire cycle. Although it never compared with Standard Oil in ability to suppress independents, its profits were enormous over a period of thirty years.

These two enterprises were the archdemons in the public mind of 1890. The objections to Standard Oil were directed not so much against its price policy or the quality of its products as against the practices used by it in intimidating and eliminating competitors. While its record of gigantic profits shows ample margin for price reductions beyond those effected, the general tendency was toward a gradual reduction in the price spread between crude and refined oil. Complaints of deteriorated quality were common in regard to export oil, but the kerosene sold in the domestic market seems to have been consistently of the highest grade. The Standard's competitive methods, however, constituted a well-nigh exhaustive catalogue of practices generally considered against commercial morality. Railroad rebates and control of pipe lines have already been described. In addition, it employed widespread local price cutting, sometimes below cost, to eliminate competition, and compensated itself by increased prices in noncompetitive markets. Bogus independents, secretly controlled by Standard, were launched in various local areas. Commercial espionage was elaborately developed. Wholesalers and retailers buying from independent refiners were threatened with destructive competition, even in grocery lines wholly unconnected with oil. Independent pipe lines would find the entire supply of crude oil at the transmitting end suddenly monopolized by Standard. Producers, whose prices were dictated to them by the monopoly, came to be its most relentless enemies.

Besides these practices, the trust indulged in various forms of political pressure. It lobbied in state legislatures, sometimes with the aid of direct bribery, against the authorization of new pipe lines.

It had its men in both Houses of Congress; they saw that "favorable" committees received consideration of proposed legislation prejudicial to Standard interests. Senators Quay and Penrose of Pennsylvania were both said to be on its payroll [8] and did their best to make the Industrial Commission of 1898 friendly to the trust. Under these conditions, the antagonism which began among producers spread through independent refiners and distributors and ended by encompassing unorganized consumers. There was a particular sentimental appeal in the thought that this private "moloch of monopoly" controlled the price of kerosene, the poor man's source of light.

In the case of sugar, price policy and political corruption played a more important role, although here, too, questionable competitive methods were not lacking. A frank policy of production limitation and price increase whenever possible was combined with complete control of the sugar tariff. Elimination of foreign competition was indispensable to the sugar trust's domestic price policy, and the trust was generally supposed to have bought its tariff protection directly. In addition, the Company was later found to have corrupted revenue officers into short-weighting raw sugar, thus saving itself several millions of dollars in duty. Havemeyer's blunt "damn the public" attitude also contributed to resentment against this monopoly in an article of universal consumption.

Organization on a large scale of political action against industrial monopolies went hand in hand with the movement described in Chapter 8 for governmental control of the railroads. The agricultural depression of the seventies, which produced the Granger movement, was blamed by many farmers on excessive charges for transportation and distribution of their produce. Monopolistic practices, they felt, led not only to low prices for their own products but also to high prices for agricultural machinery and other manufactured goods which they bought. Railway discrimination was fought partly because it was supposed to foster industrial monopoly, a supposition borne out by revelations concerning Standard Oil. While the Grange itself was chiefly concerned in its early years with regulating the railways and promoting industrial co-operatives among the farmers, it laid the foundations for political organization of the agrarian element. During the seventies important third

[8] J. T. Flynn, *God's Gold* (1932), p. 370.

parties under the name Antimonopoly, Independent, or Reform, arose in eleven Midwestern and Northwestern states. Iowa's Antimonopoly Party demanded in 1874 legislation to "secure the industrial and producing interests of the country against all forms of corporate monopoly and extortion." [9] An Antimonopoly candidate for the Presidency appeared in the campaign of 1884.

Directed primarily against the railways and grain elevators, the Granger movement obtained no legislation against industrial monopolies in general, but it was the direct ancestor of the various Farmers' Alliances, and later of the National People's (Populist) Party of 1892. A vigorous crop of such agrarian organizations arose in both the South and West during the eighteen-eighties, some of them marching out tentatively for an alliance with newly organized labor. Their press thundered against the trusts. Toward the end of the decade, agrarian or farmer-labor parties obtained majorities or balances of political power in a number of state legislatures, panicking the older parties into liberal competitive bidding for their support. By 1890 they controlled eight states, forty-four Congressmen and a handful of Senators, and were jockeying for the formation of a national third party. The spirit of the movement, as far as trusts are concerned, is well illustrated by a passage from W. S. Morgan, of the Wheel and Alliance:

> The agricultural masses, the most numerous and important of any class of people forming the great body of the republic . . . are robbed by an infamous system of finance; they are plundered by transportation companies; they are imposed upon by an unjust system of tariff laws; they are deprived of their lands and other property by an iniquitous system of usury; they are fleeced by the exactions of numerous trusts; they are preyed upon by the merchants, imposed upon by the lawyers, misled by the politician and seem to be regarded as the legitimate prey of all other classes. Monopoly names the price of what they have to sell, and charges them what it pleases for what they are compelled to buy. . . . Individual effort is fruitless. The relentless, remorseless, and unyielding grasp of monopoly is upon every avenue of trade and commerce. . . . Monopolies exist by law, are chartered by law, and should be controlled by law. A trust is a conspiracy against legitimate trade. It is against the interests of the people and the welfare of the public. It is demoralizing in its influence, inconsistent with free institutions and dangerous to our liberties. To participate in a trust should be a crime subject to severe punishment.

[9] S. J. Buck, *The Granger Movement* (1913), p. 236.

Trust is only another name for monopoly. Monopoly is wielding a greater power in the government than the people.[10]

Morgan called for severe criminal penalties, state and federal, against monopolists of every variety, and pled for the formation of a national party to force their enactment. It was this embryo farmer-labor movement which put the first American antitrust laws on the statute books.

COMBINATIONS AT COMMON LAW

Even before the enactment of new statutes, the antimonopolists were not wholly devoid of legal protection against restraints on competition. The tradition of the common law, expounded by the various state courts as part of the law of the land, was in close sympathy with their objectives. Two branches of the law, each the product of centuries of exposition and refinement, were in particular conflict with the combination movement. Contracts in restraint of trade were unenforceable in the courts. Monopoly was illegal. Each of these doctrines, however, had a limited and technical meaning, the fruit of experience with an economy strikingly different from that of late-nineteenth-century America.

The doctrine of restraint of trade, going back to the *Dyer's* case of 1415, originally concerned contracts whereby one party agreed not to compete with the other in a local market—contracts generally made in connection with the sale of a business. As transportation improved and markets expanded, the possibility of outside competition made such agreements less objectionable as a matter of public policy. The law was then modified to permit restraints when reasonably ancillary to the main purpose of the sale, in order to ensure to the buyer the uncontested use of "good will" built up by the seller, provided that such restraints were not part of a monopolistic scheme injurious to the public.[11] By analogy, however, this branch of the law could be extended to cover restraints upon competition, that is, agreements whereby the parties sought

[10] W. S. Morgan, *History of the Wheel and Alliance, and the Impending Revolution* (1889), pp. 15–17.

[11] A distinction was made at one time between *general* restraints, which were void, and *particular* restraints, limited to one locality, which might be enforceable. See *Mitchel* v. *Reynolds*, 1 P. Wms. 181 (1711). By the late nineteenth century, however, this distinction was no longer of importance.

to exclude others from the market.[12] The minds of common-law judges were well prepared for this extension by the second ancient principle, which voided monopolies as against public policy.

The term "monopoly" referred originally only to exclusive trading rights granted by the Crown, similar to the modern patent. Such grants were particularly common under the Tudor monarchs, who found it easier to obtain revenue in this manner than from a recalcitrant Parliament. In *Darcy* v. *Allein* (1602), an English court voided a monopoly in the importation and sale of playing cards, holding that monopoly is accompanied by three inseparable incidents:

> 1. That the price will be raised. 2. After the monopoly grant, the commodity is not so good as it was before. 3. It tends to the impoverishment of divers artificers and others who before by their labour had maintained themselves and their families, who now will of necessity be constrained to live in idleness and beggary.[13]

All Crown grants of monopoly were repealed by Acts of Parliament in 1624 and 1689. Subsequently the meaning of the word was broadened into its more modern usage, including substantial or exclusive market control however obtained. Sixteenth-century statutes against engrossing (cornering the market), regrating (acting by any means to raise the price of victuals), and forestalling (buying up commodities on their way to market in order to sell them at higher prices) served as signposts to the courts in extending common-law inhibitions against monopolization. Fearing the same results which had led earlier judges to inveigh against monopoly and restraint of trade in the narrower senses, state judges in the nineteenth century were ready to apply the law against pools, trusts, and other devices of the new combination era.

In the narrow and relatively unimportant field of technical *contracts* in restraint of trade, a "rule of reason" had been developed which validated most such contracts. In the wider field of *combinations* in restraint of trade, or restraints upon competition, the American courts, with few exceptions, recognized no such rule. The cases have been summarized thus: "Wherever any agreement between competitors appears to involve an undue restriction of competition

[12] See, for example, *Hubbard* v. *Miller,* 27 Mich. 15 (1873); *Diamond Match Co.* v. *Roeber,* 106 N.Y. 473 (1887).

[13] 11 Coke 84b.

and therefore to be detrimental to the public interest the courts will refuse to aid in its enforcement." [14] Pools of every variety were held illegal in various states during the second half of the nineteenth century. They included agreements to control the output of a commodity, to divide market territory among competitors, to pool earnings, and to employ a common sales agency to effectuate price control. The impossibility of holding defaulting members of a pool to their agreement through the ordinary legal processes was the prime inducement to businessmen to search for tighter and more effective forms of combination. These, too, however, came within the ban.

Two cases of prime importance outlawed the trust. In *People* v. *The North River Sugar Refining Company,*[15] the New York courts vacated the Company's charter on the ground that it had no legal authority to join the Sugar Trust or to place control of its affairs in the hands of another organization. The Court of Appeals refused to follow the lower court in declaring the Sugar Trust to be against public policy, restricting itself solely to the question of corporate powers of the North River Company. In *State* v. *Standard Oil Company* [16] the Ohio Supreme Court went further, and held the Oil Trust itself to be an unlawful monopoly. Its words summarize admirably the broad attitude of the common law:

> [The object of the agreement] was to establish a virtual monopoly of the business of producing petroleum, and of manufacturing, refining and dealing in it and all its products, throughout the entire country, and by which it might not merely control the production, but the price at its pleasure. All such associations are contrary to the policy of our state and void. . . . Much has been said in favor of the objects of the Standard Oil Trust, and what it has accomplished. It may be true that it has improved the quality and cheapened the costs of petroleum and its products to the consumer. But such is not one of the usual or general results of a monopoly; and it is the policy of the law to regard, not what may, but what usually happens. Experience shows that it is not wise to trust human cupidity where it has the opportunity to aggrandize itself at the expense of others. . . . Monopolies have always been regarded as contrary to the spirit and policy of the common law. . . . A society in which a

[14] Commissioner of Corporations, *Trust Laws and Unfair Competition* (1915), pp. 37–38.

[15] 121 N.Y. 582 (1890).

[16] 49 Ohio 137 (1892).

few men are the employers and the great body are merely employees or servants, is not the most desirable in a republic; and it should be as much the policy of the laws to multiply the numbers engaged in independent pursuits or in the profits of production, as to cheapen the price to the consumer. Such policy would tend to an equality of fortunes among its citizens, thought to be so desirable in a republic, and lessen the amount of pauperism and crime. . . . The effect on industrial liberty and the price of commodities will be the same whether created by patent, or by an extensive combination among those engaged in similar industries, controlled by one management. By the invariable laws of human nature, competition will be excluded and prices controlled in the interest of those connected with the combination or trust.

The Cotton Seed Oil Trust and Whiskey Trust were likewise attacked successfully in Tennessee and Nebraska.[17] Thenceforth the trust proper was abandoned. A few years later its successor organizations were also defeated in the courts. The Illinois Supreme Court castigated the Distilling and Cattle Feeding Company in 1895. "There is no magic in a corporate organization which can purge the trust scheme of its illegality, and it remains as essentially opposed to the principles of sound public policy as when the trust was in existence. It was illegal before and is illegal still, and for the same reasons." [18] In the same year the New York Court of Appeals forfeited the charter of the Milk Exchange Limited, a combination of dealers to control the purchase price of raw milk, on similar grounds.[19]

It will be seen, therefore, that the attitude of the common law was in general harmony with the rising antitrust movement. Judicial declarations of public policy favored the maintenance of competition as a self-regulating device which would ensure the public welfare. No highly refined economic theory went into the decisions, but even professional economists of the day were mostly content with the simple dichotomy between competition and monopoly, the former needing no interference and the latter a potential danger to its customers and sellers alike even if it had not in fact unreasonably affected prices. The above words from the Ohio case show, too, that some of the courts, like the Populists, feared monop-

[17] *Mallory* v. *Hanaur Oil-Works*, 86 Tenn. 598 (1888); *State* v. *Nebraska Distilling Co.*, 29 Neb. 700 (1890).

[18] *Distilling and Cattle Feeding Co.* v. *People*, 156 Ill. 448 (1895).

[19] *People* v. *Milk Exchange*, 145 N.Y. 267 (1895). See also *Richardson* v. *Buhl*, 77 Mich. 632 (1889), condemning the Diamond Match Company.

oly for its revolutionary effects upon free enterprise in general and the old established "American way of life."

Nonetheless, the growth of the combination movement in the face of these legal obstacles proved the common law to be inadequate. Its defects lay not so much in its content as in the technique of its application. Loose agreements of the pooling variety were generally brought into court only when some disgruntled member began an action or was himself sued for noncompliance. Remedies were difficult to enforce and rarely succeeded in restoring competition. In most cases the law simply refused to aid the combination; it offered no positive hindrance. Criminal penalties could be applied only if combinations were adjudged criminal conspiracies, a fate which overtook some early labor organizations but not trusts. Moreover, the common law was state wide only, and a large combination could operate in other states after being condemned in one. The jurisdictions varied in the severity with which their judges applied the law. There was no uniformly applicable federal common law. It was clear from the results that if the trust problem were to be attacked by forbidding and breaking up monopolistic enterprises, statutory enactments and new administrative machinery were essential.

STATE ANTITRUST LAWS

Antitrust legislation is in force at the present time in more than forty states, many of them employing constitutional as well as statutory prohibitions. Provisions against state-granted monopolies go back to the earliest period of our national history, but legislation against industrial combinations began only in 1887, the year of the formation of the Whiskey and Sugar Trusts. It became widespread only in 1889. Knowledge of railway rate preferences granted to the Standard Oil and other groups had been made available by the New York Hepburn committee in 1879 and by various state lawsuits. The topic had been popularized by Henry Demarest Lloyd in 1881 in his *Story of a Great Monopoly,* and had been particularly emphasized by the federal Cullom Committee's railway investigation of 1885–86. The Cullom report, which immediately preceded adoption of the Interstate Commerce Act of 1887, stressed the part played by railway discrimination in fostering industrial monopolies, and the Act itself was directed primarily against "unreasonable preferences."

The rising tide of antitrust agitation in the public press and in petitions to legislatures produced a number of additional official investigations in 1888. The Canadian Parliament's report on "Alleged Combinations in Manufacture, Trade and Insurance" shed new light on monopolistic practices on both sides of the border. A committee of the New York Senate took testimony on combinations in sugar, milk, rubber, cottonseed oil, petroleum, oilcloth, envelopes, meat, glass, furniture, copper, jute bagging, grain elevators, and groceries, and laid bare for the first time the text of the Standard's Trust Agreement. While most of the members felt that the dangers had been exaggerated and that immediate state legislation was undesirable, the evidence produced before this committee served as a basis for action elsewhere. It also inspired the suit against the North River Sugar Refining Company. At the same time, the Committee on Manufactures of the federal House of Representatives also explored the leading trusts in some detail.

Beginning in the Granger sections, a wave of antimonopoly statutes swept the country. By the middle of 1890, when the first federal antitrust act was adopted, seventeen states and territories had passed such laws, six of them in the form of constitutional provisions. The marked and significant sectional character of the movement is indicated by the almost solid geographical grouping of the states, beginning with Washington in the Northwest and running through Idaho, Montana, Wyoming, the Dakotas, Nebraska, Kansas, Texas, Iowa, Missouri, Mississippi, Tennessee, North Carolina, and Kentucky. Only Michigan and Maine were outside this main bloc of agrarian revolt. By 1900 thirteen more states had joined the movement: Utah, New Mexico, Oklahoma, Arkansas, Louisiana, Georgia, and South Carolina in the South and Southwest, and Minnesota, Wisconsin, Illinois, Indiana, Ohio, and New York in the North. The laws varied considerably in content, but in almost all cases forbade monopolies and combinations in restraint of trade in general terms, and provided criminal penalties and administrative machinery for prosecutions where the common law had merely made contracts unenforceable. In addition, they attacked particular forms of agreement and specific practices which were thought especially likely to bring about market control.

Since the turn of the century, there have been few examples of substantial modification of antitrust policy in the states. While the statutes are often more thoroughgoing, both in definition of offenses

and in prescription of remedies, than the federal law, their importance has increased in step with the increasing proportion of interstate business. Enforcement has generally been haphazard and ill financed. A recent writer has aptly said that "these laws raise more smoke than fire." [20] Their fundamental difficulty lies in the impossibility of dealing with national or international economic institutions through limited political areas. The pacemaker in America's industrial policy has been, of necessity, the federal government.

THE SHERMAN ACT OF 1890

The adoption of the Sherman Act is a curious phenomenon of our political history. Unlike the Interstate Commerce Act, it was not the fruit of exhaustive investigation and careful debate, a response to overwhelming demand from directly interested groups. Unlike the supplementary antitrust legislation of 1914, it was not the product of a professedly liberal President and party newly installed in office. While hindsight justly views it as one of the most important measures ever passed by Congress, it is doubtful if any member of the 51st Congress so thought of it. The dominant Republican Party, itself dominated at the time by many of the very industrial magnates most vulnerable to real antitrust legislation, made the unprecedented tariff increases of the McKinley Bill the chief business of the session. Despite the peculiar notoriety of the Sugar Trust, the new tariff favored it by preserving a duty on refined sugar and admitting the raw material free. The paradoxical passage of an antimonopoly statute in the same year, with only one dissenting vote, was chiefly due to Republican fears that the Party might lose its Western section, either to the Democrats or to the new third party then taking shape. Even from that viewpoint it was treated by Congress as secondary to the Sherman Silver Purchase Act. Mason of Illinois stated the case succinctly:

> You [the Democratic members] use the "trust" as a bugaboo to frighten people away from the Republican party into your ranks. That is the reason you do not want the Republican party to strike a blow at trusts today. The moment that we strike down trusts in this country that moment there is taken away one of the principal elements of your political

[20] "Collection and Survey of State Antitrust Laws," 32 *Columbia Law Review,* 347, 364 (1932).

talk in seeking to drive the farmers away from the Republican party into the Democratic party.[21]

The importance of the trust issue in the public mind made it too obvious a political asset for wise politicians to ignore. Having lost the Presidency in 1884 for the first time since the Civil War, Republicans were in no mood to risk the defection of geographical sections essential to their Party's continued stability. Nor could their opponents sensibly refuse an opportunity to pry away the avowedly antimonopolist agrarian Republicans from the increasingly powerful Eastern industrial section of the Party. In 1884 the Democrats officially adverted to the issue; in 1887 President Cleveland suggested a relationship between tariffs and trusts—a favorite Democratic theme—but on neither occasion was legislation suggested. In 1888 the Republicans, hitherto silent, joined the Democrats in writing an antitrust plank into their platform, but its vague terms merely recommended "such legislation as will prevent the execution of all schemes to oppress the people by undue charges on their supplies, or by unjust rates for the transportation of their products to market." Various bills were introduced in 1888 and 1889, but no action was taken on them. In his first message to Congress, President Harrison gave the subject a paragraph, advising "prohibitory legislation" as far as the limited federal jurisdiction might permit. Thus, antagonism to trusts became an ostensibly bipartisan policy, but it was in fact believed in strongly by the leaders of neither party.

The Act of 1890 was in no sense a well-considered measure. The House Manufactures Committee had failed to make specific recommendations in 1889 because of disagreement among its members. No hearings were held on the bill. The debates covered only five and a half days and neither deserved nor received close attention from members. Questions of constitutionality and interparty discussions on the relation between tariff protection and monopoly took up the bulk of the time.[22] Only Senator Stewart of Nevada spoke against the general policy, contending that the sole workable corrective for private combination was co-operative combination. Congressman Culberson, in reporting the bill from the House Ju-

[21] 21 *Congressional Record* 4098 (1890).

[22] It is perhaps significant that an amendment to withdraw tariff protection from monopolistic combinations was defeated in the Senate by a vote of 26 to 16. 21 *Congressional Record* 2615 (1890).

diciary Committee, thought it could be disposed of in short order, to clear the way for supposedly more important measures on copyrights and bankruptcy. The text of the operative sections was written by Senator Edmunds in the Senate Judiciary Committee, and it is fruitless to search the debates for specific "Congressional intent" as to its meaning. The enactment was justly ascribed by Platt of Connecticut to a desire "to get some bill headed: 'A Bill to Punish Trusts' with which to go to the country."[23] The law was approved on July 2, 1890.

3. Early Application of the Sherman Act

The heart of the Act lies in its first two sections. In their original form[24] they read as follows:

> Sec. 1. Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal. Every person who shall make any such contract or engage in any such combination or conspiracy, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding five thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.
>
> Sec. 2. Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding five thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.

Three methods of action in the courts against violators are provided: criminal prosecutions brought by federal attorneys, proceedings in equity instituted by federal attorneys to enjoin and restrain violations, and suits for damages by private parties injured "by reason of anything forbidden or declared to be unlawful by this act," who if successful are to recover thrice the amount of damage sustained.[25]

[23] L. A. Coolidge, *An Old-fashioned Senator: Orville H. Platt* (1910), p. 444.

[24] In 1937, Section 1 was altered by the Miller-Tydings amendment to legalize resale price maintenance. See below, pp. 604–605.

[25] The Wilson Tariff Act of 1894 imposed similar penalties (but with minima of $100 fine and three months' imprisonment) for combinations, conspiracies, trusts,

Couched in these extremely broad terms, the Sherman Act was neither self-explanatory nor self-enforcing. Taken at their face value, its words covered at a minimum practices heretofore frowned upon by the common law, and made that law applicable by the federal courts to interstate commerce. It replaced mere unenforceability of contracts by liability to equitable restraints and criminal penalties. It clearly included, in one section or the other, the most notorious trusts of the eighties, which were referred to time after time in the Congressional debates. At a maximum, a literal reading would proscribe every form of concerted activity, not only by industrial entrepreneurs but also by farmers, laborers, or any other organized group, which in any way adversely affected the flow of interstate commerce.

The extent to which the general public policy represented by the statute would become effective depended upon four factors: (1) the meaning given to it by the courts in its application to specific cases; (2) the sympathy of the Department of Justice with its objects and the vigor with which it attacked violators; (3) the sympathy of subsequent Congresses in providing funds and personnel for enforcement and in enacting supplementary legislation when necessary; and (4) the adequacy of injunction, dissolution, or criminal penalties in restoring a competitive situation in cases where prosecutions were successful. As far as the major industrial combinations whose actions led to the legislation are concerned, the combined working of these factors made it almost a dead letter for its first two decades.

During the administrations of Presidents Harrison, Cleveland, and McKinley, little enthusiasm was shown by the executive for the purposes of the Act. Only eighteen actions were brought in the entire period. From 1898 to 1901, when new combinations were being formed at a rate never equaled before or since, the sole suit instituted by the government concerned a relatively minor coal and

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agreements, or contracts in restraint of trade in the importation of goods from abroad.

The Webb-Pomerene Export Trade Act of 1918 exempted from the Sherman Act associations engaged in export trade, provided that they did not restrain trade within the United States or restrain the export trade of any domestic competitor. Co-operation among exporters in the rivalry with international competitors was thus approved by Congress. Export trade associations were subjected to administrative supervision by the Federal Trade Commission. For a review of the operation of the Webb-Pomerene Act, cf. Temporary National Economic Committee, *Export Prices and Export Cartels* (*Webb-Pomerene Associations*), Monograph No. 6 (1940), pp. 113–300.

coke pool. Richard Olney, Attorney General from 1893 to 1895, was positively hostile, first vainly attempting to get the Act repealed and later writing: "You will have observed that the government has been defeated in the Supreme Court on the trust question. I always supposed it would be and have taken the responsibility of not prosecuting under a law I believed to be no good—much to the rage of the New York *World*." [26] There were no special funds set aside for antitrust law enforcement. Even under more friendly Attorneys General, the Department of Justice was hampered by lack of investigatory facilities, which made it exceedingly difficult to collect evidence against secret violations. The first outstandingly successful prosecution, against the Addyston Pipe Pool, was made possible only by the revelations of a disgruntled stenographer.

Two early, halfhearted attempts to reach large trusts both ended in miserable failure. A federal court in Massachusetts quashed an indictment against officers of the Whiskey Trust on a narrow technicality.[27] Subsequent decisions in three other districts tended to restrict the Act. The first case to reach the Supreme Court, *United States* v. *E. C. Knight Co.*,[28] was a bill in equity against the Sugar Trust, which had just gained control over all but 2 per cent of the domestic refining industry. On the ground that control of the manufacturing process affected commerce "only incidentally and indirectly," and was therefore subject only to state regulation under our federal system, the Court, with only one dissent, dismissed the bill. Similar rulings disposed of two cases against combinations of livestock dealers in Kansas City.[29] The almost complete reversal of this extraordinary stand within a few years indicates that substantial responsibility for the fiasco rested with government counsel, who failed to stress sufficiently the actual effect of the sugar combination on interstate sales of the refined product. The immediate consequence of the *Knight* decision, however, was a feeling that without a constitutional amendment industrial combinations were

[26] Quoted in H. S. Cummings and C. McFarland, *Federal Justice* (1937), pp. 322–323.

[27] *United States* v. *Greenhut*, 50 Fed. 469 (1892). On the other hand, the constitutionality of the Act was sustained in *United States* v. *Jellico Mountain Coal and Coke Co.*, 46 Fed. 432 (1891).

[28] 156 U.S. 1 (1895).

[29] *United States* v. *Hopkins*, 171 U.S. 578 (1898); *United States* v. *Anderson*, 171 U.S. 604 (1898).

safe from federal law.[30] At the same time, the Sherman Act proved to be applicable in two other fields, unrelated to its primary objectives.

A circuit court in Louisiana granted an injunction against striking warehousemen in New Orleans in 1893, and its interpretation of the Act to include labor unions was followed by the Supreme Court in the *Debs* case two years later.[31] In 1908 the Act enabled the Danbury hat manufacturers to recover treble damages to the amount of $222,000 from their striking workmen in the famous case of *Loewe* v. *Lawlor*.[32] This application of the Act was a potent factor in arousing demands for its revision, and lent color to the charges of liberal critics that a reactionary judiciary was abusing it by penalizing unions while exempting industrial malefactors. The government also won two leading cases against railroad combinations, which were thought by many to be covered exclusively by the Interstate Commerce Act of 1887 and therefore to be outside the scope of the Sherman Act. In reversing two lower courts in a five to four decision, the Supreme Court in 1897 dissolved the Trans-Missouri Freight Association, a combination of Western railroads which fixed rates by agreement.[33] The majority held the agreement void irrespective of whether the rates actually fixed were reasonable or not. In the following year a similar decision, by five to three, outlawed a rate fixing association of Eastern railroads.[34]

In the industrial field, the *Addyston Pipe and Steel Company* case,[35] decided in 1899, marked the beginning of positive application of the Sherman Act. This case concerned an elaborate pooling agreement among six manufacturers of cast-iron pipe, used mostly for gas and water works, in Ohio, Kentucky, Tennessee, and Alabama. Although they controlled only 30 per cent of the country's total manufacturing capacity, high transportation costs gave them a limited monopoly power in near-by territory. Orders from a num-

[30] *Annual Report of the Attorney General*, 1896, H. Doc. 234, 54th Cong., 1st Sess., Exh. 1.

[31] *United States* v. *Workingmen's Amalgamated Council*, 54 Fed. 994 (1893), 57 Fed. 85 (1893); *In re Debs*, 158 U.S. 564 (1895).

[32] 208 U.S. 274 (1908).

[33] *United States* v. *Trans-Missouri Freight Association*, 166 U.S. 290 (1897).

[34] *United States* v. *Joint Traffic Association*, 171 U.S. 505 (1898).

[35] *United States* v. *Addyston Pipe and Steel Co.*, 78 Fed. 712 (1897), 85 Fed. 271 (1898), 175 U.S. 211 (1899).

ber of designated cities were reserved for each of the member companies. In a further considerable area, known as "pay territory," the pool conducted a secret auction among its members, awarding contracts in return for the highest bonus offered to the pool. Bonuses were later redistributed in proportion to members' capacity. In all public auctions a specious appearance of competition was preserved by prearranged high bids from members other than the one selected. Judge W. H. Taft (later President and Chief Justice), in a lucid opinion for the Circuit Court of Appeals, held that the agreement fell within the prohibitions of the antitrust law. He found the prices to be unreasonable, despite contentions to the contrary by the association. Even if the prices had been reasonable, he claimed, the scheme would have been invalid at common law and was certainly so under the Sherman Act. The *Knight* case was distinguished on the ground that the Addyston pool directly concerned itself with sales in interstate commerce, and not merely with manufacturing. The decision was affirmed by a unanimous Supreme Court.[36]

Taken together, the *Sugar Trust* and *Addyston* decisions persuaded businessmen that the federal statute constituted a real danger to loose marketing agreements and pools, but left industrial combinations through holding companies or mergers unaffected. The benevolent attitude of the McKinley administration re-enforced this conclusion. At the same time, the flood of new combinations aroused public interest and antagonism to a point far beyond the level of the late eighties. From 1899 to 1902 an Industrial Commission of nineteen members, ten from Congress and nine appointed by the President, conducted an exhaustive investigation of combinations in the oil, coal, steel, silver, whiskey, tobacco, salt, wallpaper, thread, baking powder, and other industries. Its vice-chairman was a former oil producer, one of the old enemies of the Standard, and its staff included a group of highly capable economists. Some of its Congressional members, however, were strongly protrust. The report was sent secretly to Archbold of Standard Oil for his comment and was substantially modified before publication. The Industrial Commission's collection of factual material proved more fruitful than its recommendations, which proposed increased publicity enforced through a federal licensing system and specific

[36] See also *United States* v. *Chesapeake & Ohio Fuel Co.*, 115 Fed. 610 (1902); *Continental Wallpaper Co.* v. *Voight*, 212 U.S. 227 (1909); *Montague* v. *Lowry*, 193 U.S. 38 (1904); *Shawnee Compress Co.* v. *Anderson*, 209 U.S. 423 (1908).

prohibitions of price discrimination, together with a possible modification of the tariff.

During the summer of 1899 the Civic Federation of Chicago gathered together an impressive assemblage of legislators, lawyers, governors, and other prominent citizens to discuss means of dealing with the trust problem. "The Department of Justice was flooded with petitions that trusts be investigated and destroyed." [37] In Congress a new wave of proposed legislation appeared. A constitutional amendment to remedy the *Knight* decision was supported by a majority of the lower House, but was opposed by the Democratic minority on broad states' rights principle and failed to receive the necessary two-thirds vote. In 1900 the House passed by 274 to 1 a bill slightly strengthening the Sherman Act and exempting labor organizations, but it was killed in the more conservative Senate. Strong antitrust planks reappeared in the platforms of both major parties. Yet the formation of new combinations proceeded apace.

At this juncture Theodore Roosevelt was made President by the assassination of McKinley. Aggressively opposed to excessive accretion of power in private hands, the new President declared himself in favor of thoroughgoing publicity as a remedy against corporate abuses. Under his guidance, Congress included in the new Department of Commerce and Labor, created in 1903, a Bureau of Corporations, which was to make "diligent investigation into the organization, conduct, and management of the business of any corporation, joint stock company, or corporate combination." The Bureau was armed with the power of subpoena and was empowered to lay the foundation for new legislation. In the same year a bill passed the House to compel general publicity of corporate affairs and to prohibit discriminations in local prices and in railway rates. Administration support was withdrawn in the Senate, however, and the measure was defeated by the Republican majority.

In its ten years of existence, the new Bureau contributed a valuable series of special studies to the country's industrial literature, covering among other industries meat-packing, oil, tobacco, steel, and lumber. New life was also infused by the Roosevelt administration into the Department of Justice, which instituted forty-four proceedings during this period. W. H. Moody, Attorney General from 1904 to 1906, made the first serious attempt at enforcing the

[37] Cummings and McFarland, *op. cit.*, p. 327.

criminal provisions of the Sherman Act. The Court record was moderately successful.[38] Yet the bulk of these cases were against minor pools. The only important prosecution to reach a final victorious decision during Roosevelt's term of office enjoined the "Big Four" meat packers of Chicago from conspiring to depress livestock prices and enhance meat prices.[39] The sting was shortly withdrawn from this success by the failure of a criminal prosecution on the ground that testimony before the Bureau of Corporations gave defendants legal immunity from subsequent criminal proceedings.[40]

Roosevelt's reputation as a "trust buster" depends largely upon his successful dissolution of the Northern Securities Company, the holding company set up by Hill, Morgan, and Harriman to unite the Northern Pacific and Great Northern Railroads. Outright consolidation had previously been prevented under a Minnesota statute.[41] A divided Supreme Court led by four justices, with one concurring and four dissenting, held the Company subject to the Sherman Act despite the existence of substantial outside competition and the alleged reasonableness of the rates fixed by the combination.[42] The chief significance of the case lay in its condemnation of the holding company as a method of control over previously competing companies, and its inclusion of this type of stockholding within the scope of the commerce clause.

Roosevelt left office with no major trust yet dissolved, although suits against the Standard Oil and American Tobacco combinations had begun their way through the courts. The direct effects of his two major victories were almost nil. Community of interest within the controlling Hill-Morgan group continued to direct the policy of both Northwestern railroads, while the meat packers simply disregarded the injunction in the *Swift* case. In the latter part of his term, Roosevelt lost faith in mere publicity as a sufficient solution of the trust problem. He popularized a distinction between "good" and "bad" trusts. "Good" trusts gained their position through economies of large-scale operation short of complete monopoly, and

[38] Eleven pleas of guilty or convictions were obtained in twenty-five criminal cases; fourteen injunctions, dissolutions, or consent decrees were obtained in eighteen equity proceedings; and one suit for forfeiture failed.

[39] *United States* v. *Swift & Co.*, 196 U.S. 375 (1905).

[40] *United States* v. *Armour & Co.*, 142 Fed. 808 (1906).

[41] *Pearsall* v. *Great Northern Railway*, 161 U.S. 646 (1896).

[42] *Northern Securities Co.* v. *United States*, 193 U.S. 197 (1904).

took no unfair advantage of competitors or consumers; "bad" trusts engaged in unfair competition and abused their monopoly power. The new attitude emphasized regulation of specific competitive practices rather than indiscriminate repression of all monopoly. A federal commission was proposed, to which businessmen might submit in advance agreements of doubtful legality; if approved, they would be exempt from prosecution. In the lameduck session of 1909, however, a Senate Committee decisively rejected a bill to this effect, on the ground that it would set up a new form of corruptible executive dispensation. The Committee praised the Act of 1890 as "clear, comprehensive, certain and highly remedial . . . in every respect a model law." [43] The description was anything but accurate, but Congress was not yet prepared to strike out on new paths.

President Taft, temperamentally more conservative than his predecessor, was endowed by his judicial experience with far more faith in purely legal remedies for economic problems. He took office with the conviction that the Sherman Act, if properly enforced, would effectively carry out a desirable antitrust policy. His sole proposal for legislative change, which was not pressed, called for federal incorporation as a safeguard against financial mismanagement and as a means of protection for investors. Prosecutions under the Sherman Act were pushed with unprecedented vigor. Seventy-eight suits were instituted during the four years of Taft's administration, compared with only sixty-two during the entire previous period since 1890. In 1911, the *Standard Oil* and *American Tobacco* cases were both brought to a victorious conclusion in the Supreme Court. The Sherman Act was thus successfully applied for the first time against typical trusts.

After 1911, interpretation of the Sherman Act diverged along two fairly distinct paths. In the field of pools, trade associations, and other loose agreements among competitors, the Act continued to be applied with considerable rigor. The further development of public policy in this area will be treated in Chapter 15. In the field of close consolidations, on the other hand—the type of economic enterprise against which the law was originally directed—Sherman Act interpretation, by a curious paradox, evolved in far more lenient fashion.

[43] S. Rept. 848, 60th Cong., 2nd Sess. (1909).

4. The Sherman Act and Close Consolidations

"As a charter of freedom," the Supreme Court has recently said of this statute, "the Act has a generality and adaptability comparable to that found to be desirable in constitutional provisions."[44] Since 1911 a large proportion of the most prominent American concerns have appeared in court under its terms, about ninety of them as defendants in government suits alleging restraint of trade through mergers or other forms of close combination. Consent decrees[45] favoring the government have been obtained in over one quarter of the cases, as well as a substantial number of victories in the courts. In the few cases which have reached the highest court, however, the course of interpretation has been obscure. Public antitrust policy in practice, therefore, has always been ill defined. Neither businessmen nor the Department of Justice can yet find in these decisions a sure guide to the limits of permissible action.

The phraseology of the Supreme Court's opinions in the *Standard Oil* and *American Tobacco* cases, delivered in 1911, foreshadowed the uncertainties in the law which were later to become evident. After the Ohio decision against the Trust in 1892, the Standard group depended for a number of years upon the nine ex-trustees' community of controlling interest to effectuate their objectives. A dramatic trial to adjudge them in contempt of court, brought in Ohio in 1897, led to reorganization of the business under a New Jersey holding company. In 1899, therefore, the capital of the Standard Oil Company of New Jersey was increased from $10,000,000 to $110,000,000, and it was given voting control over the other companies of the group through exchanges of stock. A report by the Bureau of Corporations showed that in 1906 about 91 per cent of the refining industry was directly or indirectly under Standard control, and that the old methods of the group had been continued under the new form of organization.

In that year Attorney General Moody brought an action in equity

[44] *Appalachian Coals, Inc.* v. *United States,* 288 U.S. 344 (1933).

[45] A consent decree is a court decree entered against the respondent in an equity proceeding by his own consent. It is obtained by informal negotiation between the government and the respondent. It is enforceable through contempt proceedings in precisely the same manner as a contested decree entered by a court after litigation. Unlike the contents of a contested decree, however, those of a consent decree do not necessarily reflect an authoritative interpretation of the law.

for dissolution of the trust. After protracted litigation and repeated offers by the Rockefeller interests to arbitrate, the government won a complete victory in the Circuit Court at the end of 1909. In 1911 the decision was unanimously affirmed by the Supreme Court.[46] In his opinion, however, Chief Justice White insisted that the Sherman Act condemned only "unreasonable" restraints of trade, despite the text of the statute and the clear prior decisions to the contrary, from which he had dissented. Verbose and confusing, the opinion laid special emphasis upon the intent and methods of the combination. White claimed to be following the common law, which in his opinion prohibited:

> contracts or acts which were unreasonably restrictive of competitive conditions, whether from the nature or character of the contract or act, or where the surrounding circumstances were such as to justify the conclusion that they had not been entered into or performed with the legitimate purpose of reasonably forwarding personal interest and developing trade, but, on the contrary, were of such a character as to give rise to the inference or presumption that they had been entered into or done with the intent to do wrong to the general public and to limit the right of individuals, thus restraining the free flow of commerce and tending to bring about the evils, such as enhancement of prices, which were considered to be against public policy.

The inarticulate major premise behind the opinion is implicit in phrases expressing "a profound conception as to the inevitable operation of economic forces and the equipoise of balance in favor of the protection of the rights of individuals which resulted," and:

> a consciousness that the freedom of the individual right to contract when not unduly or improperly exercised was the most efficient means for the prevention of monopoly, since the operation of the centrifugal and centripetal forces resulting from the right to freely contract was the means by which monopoly would be inevitably prevented if no extraneous or sovereign power imposed it and no rights to make unlawful contracts having a monopolistic tendency were permitted.

As this quotation indicates, the Chief Justice's faith was not so much in competition as in a view of laissez faire which regarded economic maladjustments as almost always automatically self-correcting; con-

[46] *United States* v. *Standard Oil Co. of New Jersey*, 173 Fed. 177 (1909); 221 U.S. 1 (1911).

sequently, he could not stomach an unvarnished literal interpretation of the statute's condemnation of *"every* combination . . . in restraint of trade."

Against this faith, the forceful and logical concurring opinion of Justice Harlan proved unavailing. Harlan termed the majority's introduction of the rule of reason into the Act a piece of "judicial legislation" and "usurpation." In his mind, it was "a serious departure from the settled usages of this court," which would "entirely emasculate the Antitrust Act" and "throw the business of the country into confusion and invite widely extended and harassing litigation." The entire Court agreed in condemning the Standard Oil Company, but the Chief Justice spoke of its size and power as creating only a *prima facie* presumption of intent to dominate the industry by abnormal methods. The decision really turned upon proof of those methods, including railway rate discriminations, local price cutting, commercial espionage, use of bogus independents, territorial allocation of markets to member companies, and monopolization of the means of transportation. The implication was inescapable that had the defendants relied only upon "normal methods of industrial development" they might have escaped the condemnation of the Act as now interpreted.

The Tobacco combination dated from 1890, when J. B. Duke consolidated five cigarette manufacturers into the first American Tobacco Company. Technical improvements at this time had made expensive machinery indispensable to low-cost manufacture. The Company sought to gain exclusive use of the best patents and immediately entered upon a campaign to acquire its leading competitors in all branches of the trade. "Fighting brands" competing with the output of particular competitors, sold below cost and financed out of cigarette profits, were a potent instrument of the trust in accomplishing its ends. It also made extensive use of bogus independents, which sought the patronage of groups opposed to the trust on general principles or because of its hostility to organized labor. Large competitors were frequently glad to join the combination at handsome prices, rather than risk the losses of such warfare. Many of the plants thus acquired were subsequently shut down and the ex-competitors were required to agree not to re-enter the business. By 1900, the combination produced from 50 to 90 per cent of every type of tobacco product except cigars. So little capital was required in the latter branch, where manufacturing was largely

by hand, that independent competition proved indestructible. In 1904 a new merger, also called the American Tobacco Company, replaced the former network of interlinked holding and operating companies, although a number of subsidiaries retained their separate corporate existence. The trust engendered bitter resentment among tobacco growers and such independents as remained.

In 1907, therefore, dissolution proceedings were brought. A partial government victory in the lower court was appealed by both sides to the Supreme Court, where the entire government contention was upheld.[47] Chief Justice White, over Justice Harlan's objection, again expounded the rule of reason. Laying great weight upon the evidences of "conscious wrongdoing," he found that:

> the history of the combination is so replete with the doing of acts which it was the obvious purpose of the statute to forbid, so demonstrative of the existence from the beginning of a purpose to acquire dominion and control of the tobacco trade, not by the mere exertion of the ordinary right to contract and to trade, but by methods devised in order to monopolize the trade by driving competitors out of business, which were ruthlessly carried out upon the assumption that to work upon the fears or play upon the cupidity of competitors would make success possible.

Here again, it seemed, it was not so much the monopolistic position actually achieved, but the purposes and methods of the combination, which constituted the real infringement of the Act. A month later similar reasoning was applied by a circuit court in dissolving the Du Pont explosives combination of 1904.[48]

The enunciation of the rule of reason evoked a storm of controversy. Taking their cue from Justice Harlan, liberals denounced it as judicial legislation, emasculating the purposes of the Sherman Act and leaving to the courts an unwarranted power to exempt "good" trusts. Ex-President Taft later defended the rule on the ground that the common-law standard of reason, which the Court claimed to have adopted, was perfectly precise, and that it forbade all monopolization and also all restraints of trade except those ancillary to another dominant, legal objective.[49] The flaw in this argument lay in its premise that the Court would really apply such

[47] *United States* v. *American Tobacco Co.*, 164 Fed. 700 (1908); 221 U.S. 106 (1911).

[48] *United States* v. *Du Pont de Nemours & Co.*, 188 Fed. 127 (1911).

[49] W. H. Taft, *The Antitrust Act and the Supreme Court* (1914).

a clear standard. In reality the rule to be applied was not an unambiguous common-law tradition, but the Supreme Court's opinion of that tradition. And, in fact, the judicial discretion created by Chief Justice White's reading of the common law was far broader than that drawn from the cases by Taft.

The government's striking victory over two leading trusts was, therefore, shadowed with a new uncertainty concerning future cases. Nonetheless, in the antitrust legislation of 1914 Congress did not attack the rule of reason. It left the terms of the Sherman Act unchanged, merely supplementing them with a provision in the Clayton Act against intercorporate stock acquisitions "where the effect of such acquisition may be to substantially lessen competition between the corporation whose stock is so acquired and the corporation making the acquisition or to restrain such commerce in any section or community or tend to create a monopoly of any line of commerce."

The decisions of 1911 made it clear that under certain conditions industrial trusts, whether holding companies or outright mergers, fell within the Act. Since that time there have been only three cases involving close industrial consolidations appealed to the Supreme Court under the Sherman Act and five under Section seven of the Clayton Act. In all but one the government has been unsuccessful. Its first failure was a prosecution of the United Shoe Machinery Company, which had been formed in 1899 out of seven leading companies in this field. Subsequent acquisition of numerous other companies gave it control, by 1911, of over 96 per cent of the so-called bottoming machinery, used for attaching soles to uppers, as well as a substantial proportion of all other types of shoe machinery. Most of its lines were protected by patents, and it regularly bought up new inventions as soon as they appeared. Complaints against the Company were focused upon its method of leasing machines to shoe manufacturers. No outright sales were made, and as a condition of leasing certain machines it required the use of its products for other parts of the manufacturing process. Breach of any one lease gave it the right to cancel all its leases with the manufacturer concerned. These "tying clauses" enabled it to force a complete line upon any manufacturer who found one of its machines indispensable. The legal monopoly attaching to a patent could thus be extended, in effect, to apparatus on which the patents had long expired.

Rival makers of machinery and many manufacturers of shoes felt themselves seriously damaged by the United's methods. In 1911 the government indicted President Winslow and other officers of the Corporation under the criminal sections of the Sherman Act. The Supreme Court, however, found that the original combination had been made between noncompeting companies making complementary types of machinery, and the indictment was construed not to include the leasing arrangements.[50] A contemporaneous civil action reached the Court in 1918. Speaking for four members, Justice McKenna denied the application of the Act to this combine.[51] The original constituents again were held to be complementary rather than competitive, although the evidence showed substantial overlapping in types of machinery. Subsequent acquisitions were justified as legitimate efforts for the "improvement of business and its efficiency." The size of the Company was ascribed to efficiency and its consequent power was held not to have been "oppressively used." The tying clauses were approved as legitimate conditions to the use of patented machines. Indicating extreme reluctance to interfere with a long-established combination which had subsequently made large investments and which would be difficult to dissolve in any case, the Court concluded:

> It is impossible to believe . . . that the great business of the United Shoe Machinery Company has been built up by the coercion of its customers and that its machinery has been installed in most of the large factories of the country by the exercise of power, even that of patents. The installation could have had no other incentive than the excellence of the machines and the advantage of their use, the conditions imposed having adequate compensation and not offensive to the letter or the policy of the law.

The faith in automatically operating natural harmonies and extreme laissez faire, a faith antipathetic in its very nature to a strong antitrust policy, stands out clearly in these words. Three justices dissented, finding no question but that the Company dominated the industry and that its leases restrained trade to an extent unwarranted by its patent rights. To them, the outstanding fact was the conscious achievement of a dominant position closely approaching absolute monopoly in one part of the industry and extended else-

[50] *United States* v. *Winslow,* 227 U.S. 202 (1913).
[51] *United States* v. *United Shoe Machinery Co.,* 247 U.S. 32 (1918).

where through the tying clauses. Because of expressions hostile to the Company before joining the Court, Justices McReynolds (Attorney General during earlier stages of the suit) and Brandeis (who had represented shoe manufacturers and an independent machinery company as counsel) did not participate. It is almost certain that in a full court this four to three decision would have fallen the other way.

The shoe machinery cases may possibly be explained away because of special rights attaching to patents.[52] No such explanation can account for the decision favoring the United States Steel Corporation, handed down in 1920.[53] This suit involved the nation's largest industrial enterprise, a holding company formed in 1901 with a capital of $1,100,000,000. Its leading constituents were themselves all amalgamations of smaller companies formed from 1893 to 1900. U.S. Steel was set up to forestall a threat of overexpansion and ruinous competition among its members. Those producing heavier semifinished products had been about to integrate forward into the finished lines and the manufacturers of finished products had laid plans to integrate backwards. The combination also enabled the Morgan firm and others to reap enormous promoters' profits, estimated at over $60,000,000. Heavily overcapitalized, U.S. Steel evidently expected to gain substantially from the semimonopolistic position thus achieved. It controlled at the time of its establishment about 60 per cent of the country's entire iron and steel capacity, the proportion running as high as 80 per cent for certain branches, and it later took in a number of important competitors. Nevertheless, it lost ground steadily to the independents remaining outside, so that by 1911, when the government prosecution began, its proportion of the industry had fallen to about 50 per cent.

No serious attempts were made by U.S. Steel to eliminate competition through the unfair methods practiced by other trusts. Its record was almost free from charges of local price cutting, transportation favors, commercial espionage, or restrictive contracts with customers. It chose rather to tolerate its rivals, sheltering the entire

[52] When suit was later brought against the Company under Section three of the Clayton Act, which specifically forbade tying contracts on goods whether patented or unpatented, if they tended substantially to lessen competition or create a monopoly, a seven to one decision in the Supreme Court condemned its leases. Justice McKenna dissented. *United States* v. *United Shoe Machinery Corp.*, 258 U.S. 451 (1922).

[53] *United States* v. *U.S. Steel Corp.*, 251 U.S. 417 (1920).

trade under the umbrella of its enormous power. Price competition was limited in the early years by agreements and understandings, followed in 1907 by the celebrated Gary dinners. At these "business meetings with a social aspect,"[54] Judge Gary exhorted his fellow manufacturers to preserve stability in the industry. There was thus produced an effective general understanding to maintain prices. The dinners were supplemented by various committee meetings. How large a role was played in the minds of the independents by fear of a price war against a rival with the size and financial connections of the Corporation, it is impossible to judge. The dinners came to an end in 1911, but more or less effective price leadership by U.S. Steel remained a feature of the industry until very recent years.

In its dissolution suit, the government demanded resolution of the Corporation into its component parts. It was unsuccessful in both District Court and Supreme Court. The latter again divided four to three, and it is reasonably certain that Justices McReynolds and Brandeis would have sided with the minority in this case. Speaking for the Court, Justice McKenna conceded that the promoters of the Corporation had intended to monopolize the industry, but they had, in his opinion, given up the effort before 1911. Despite the statute's condemnation of any "attempt to monopolize," he held that it was directed "against monopoly . . . not against an expectation of it, but against its realization." Since substantial independent competition remained, and the corporation had taken no steps to suppress the independents by unfair means, he could find no violation of the Act. Price-fixing agreements and the Gary dinners had been abandoned before the suit was filed; they were judged, therefore, irrelevant. The Court was satisfied as to the genuineness of competition by the testimony of the corporation itself, the independents, and two hundred out of forty thousand customers. "The law does not make mere size an offense or the existence of unexerted power an offense. It . . . requires overt acts and trusts to its prohibition of them and its power to repress or punish them. It does not compel competition nor require all that is possible." As a final consideration, the majority saw in dissolution a "risk of injury to the public interest" through the possible disturbance of foreign trade. The dissenters insisted that the combination

[54] This phrase was used by the trial judge in the District Court's opinion, 223 Fed. 55 (1915).

had gained its power not through normal growth but in "plain violation and bold defiance" of the Act, and that to let the Corporation remain "would be to practically annul the Sherman Law by judicial decree." Power to dominate the industry, not merely the abuse of such power, was to them the test of illegality.

In effect, the *Steel* decision seemed to legalize any merger short of complete monopoly, provided that the combination was not guilty of predatory practices against competitors at the time of prosecution. No consideration was given to the effect on an industry's price and output policy of a single concern producing half the total. This narrow construction of the law was followed in 1927 in the *Harvester* case.[55] The International Harvester Company was formed in 1902 by consolidation of the five leading manufacturers of harvesting machines, producing 85 per cent of the American output. Competition had previously been substantial; in the eyes of the trust organizers, indeed, so severe as to require combination. The Company later acquired a number of other concerns, extending its operations into various allied branches of agricultural implements. Independent competition was never eliminated, and by 1918 had reduced the International's proportion of the business to about 65 per cent.

In 1912 the government obtained a decree of dissolution against the Company from a District Court. Appeal to the Supreme Court was dismissed by agreement between the parties, the Company accepting a consent decree in 1918. The decree required the sale of three less important brands to independents, and forbade the International to employ more than one agent in any town. Previous exclusive agency contracts, limiting each dealer to a single line of the International's products, had given it effective local monopolies in many small communities. The government also retained the right to institute further action if competitive conditions were not restored after the war.

The Federal Trade Commission, investigating high prices in this field, reported in 1920 that the decree had not been adequate to restore competition. The Commission recommended separation of the leading McCormick and Deering brands, as well as separate ownership of a steel-producing subsidiary. The Department of Justice thereupon filed a supplemental petition requesting further dissolution in accordance with this recommendation. With three of its

[55] *United States* v. *International Harvester Co.*, 274 U.S. 693 (1927).

members not participating, the Supreme Court in 1927 refused the request. Federal Trade Commission statements were lightly dismissed as "hearsay," not deserving consideration under the legal rules of evidence. The former decree was construed as requiring compliance only with its positive provisions, which the Company had done. The International had made no attempt to dominate the industry by "compulsory regulation" of prices. In the eyes of the Court:

> The law . . . does not make the mere size of a corporation, however impressive, or the existence of unexerted power on its part, an offense, when unaccompanied by unlawful conduct in the exercise of its power. . . . And the fact that competitors may see proper, in the exercise of their own judgment, to follow the prices of another manufacturer, does not establish any suppression of competition or show any sinister domination.

In their sum effect, the *Shoe Machinery, Steel,* and *Harvester* decisions severely limited the application of the Sherman Act to close consolidations in industry. A number of cases involving railroad mergers, chronologically intermingled with the industrial cases and logically irreconcilable with them, formed a contrasting line of precedents for broader construction. In 1912, unified control of St. Louis's terminal facilities was outlawed, even though the monopoly power was not abused, largely on the ground that potential competition was wholly excluded.[56] In the *Union Pacific* (1912) and *Southern Pacific* (1922) cases, mergers were forbidden despite the presence of strong outside competition and total absence of predatory practices.[57] Again, in the *Anthracite Coal* cases (1920), a six to three decision dissolved a holding company controlling only one third of the country's output—a conclusion apparently in direct conflict with the *Steel* decision of the same year.[58] These cases went unmentioned in the *Harvester* opinion, however, and they have not generally been considered typical of the judiciary's attitude toward the antitrust law.

In the lower courts, the government has scored a few successes

[56] *United States* v. *Terminal Railroad Ass'n.,* 224 U.S. 383 (1912).

[57] *United States* v. *Union Pacific R.R. Co.,* 226 U.S. 61 (1912); *United States* v. *Southern Pacific Co.,* 259 U.S. 214 (1922).

[58] *United States* v. *Reading Co.,* 253 U.S. 26 (1920). It is noteworthy that only one justice who sided with the majority in the *Steel* decision was also with the majority in the *Reading* case.

against close consolidations. Orders for dissolution were handed down against the Du Pont powder trust (1911), the glucose trust (1916), and the Eastman Kodak combination (1915).[59] In most instances, however, the milder remedy of injunction against specific predatory practices has been preferred. Consent decrees forbidding particular unfair methods of competition have been accepted by a large number of respondents, including the American Sugar Refining Company, the General Electric Company, the American Telephone and Telegraph Company, the Victor Talking Machine Company, the Fox Theatres Corporation, the National Food Products Corporation, and the once notorious National Cash Register Company.[60] The most far-reaching consent decree in antitrust law history was entered against the leading meat packers in 1920; it forbade them to control public stockyards, wholesale or retail groceries, and livestock market newspapers. Chronic litigation since that time raises considerable doubt as to the effectiveness of this settlement in producing unfettered competition.

The outstanding example of complete monopoly in this country, the Aluminum Company of America, accepted a consent decree in 1912 which forbade agreements with foreign producers for geographical allocation of world markets. It also forbade efforts to fix the price of imported aluminum or aluminum ores, restrictive covenants with other American firms, and restrictions on competition in finished aluminum products through manipulation of the price of raw aluminum or other means of intimidation. In 1932 and 1934, jury awards of treble damages were made to a competitor who alleged that the Company's control over the price of raw aluminum had made it impossible to compete profitably in the finished goods trade, but both awards were overruled on the ground of procedural irregularities.[61] In 1937, the government began a new suit for dissolution of the Aluminum Company, which was still awaiting decision in the trial court early in 1941. If this decision is ultimately

[59] *United States* v. *Du Pont de Nemours & Co.*, 188 Fed. 127 (1911); *United States* v. *Corn Products Co.*, 234 Fed. 964 (1916); *United States* v. *Eastman Kodak Co.*, 226 Fed. 62 (1915).

[60] The consent decree has played an important part during the last few years in the active antitrust enforcement program undertaken by Assistant Attorney General Thurman Arnold. These developments are treated in Chapter 16.

[61] *Bausch Machine Tool Co.* v. *Aluminum Co. of America*, 60 F. (2d) 586; 63 F. (2d) 778; 72 F. (2d) 236; 79 F. (2d) 217. The case was ultimately settled out of court.

appealed to the Supreme Court, it will afford the first opportunity since 1927 for an authoritative pronouncement on the application of the Sherman Act to close consolidations.

Narrow judicial construction of the law has led to correspondingly limited decrees for dissolution in cases where the government has been successful in the courts. In general, it is an accepted principle that dissolution decrees should injure property rights as little as possible. They consequently seek the minimum possible disturbance of the industrial situation, and attempt merely to find a solution which would escape condemnation in an entirely new and independent suit. Under the Standard Oil decree of 1911, the Company's shares in its various operating companies were distributed among its own shareholders in proportion to their interest in the holding company. Thus, complete community of ownership, largely concentrated in the same hands as the old trust, remained. Many felt the outcome of this suit to be a pure farce. The market value of the securities concerned appreciably increased. For some time the constituent companies limited their operations to their old market areas.

Nonetheless, the passage of time slowly dispersed the ownership of the various companies, through inheritance and sale, until after the first World War they began invading each other's territory and displaying competitive advertisements on a large scale. More or less effective co-ordination of prices was broken down from time to time by severe rate wars. New companies grew up as strong as, or stronger than, the old Standard group. The situation was transformed from one of almost complete monopoly to one of typical "oligopoly," with no single firm dominating the field but with price competition highly imperfect. Finding the industry in 1931 to be "genuinely competitive," the Missouri District Court, which had retained jurisdiction to compel compliance with the 1911 decree, gave its approval to the merger of the Standard Oil Company of New York and the Vacuum Oil Company, both former members of the trust.[62] Predatory practices of the old variety largely ceased in 1911 and the problem presented to public policy by this industry became one of cartel-like agreements among the major refiners rather than market control by a single close consolidation.

The Tobacco Trust presented a more difficult situation, since various branches of the trade were generally dominated by single member companies. Separation into constituent parts would merely

[62] *United States* v. *Standard Oil Co. of New Jersey*, 47 F. (2d) 288 (1931).

have replaced one near monopoly by a series of near monopolies. The Circuit Court approved a plan submitted by the trust for division among fourteen separate companies, four in general tobacco manufacturing, two in tin foil, two in licorice, three in snuff, one foreign manufacturer, one cigar concern, and one (the United Cigar Stores Company) in the retail trade. Here, too, no provision was made against community of ownership by individuals. Stock prices again appreciated considerably.

The independents, represented by L. D. (later Justice) Brandeis, strongly criticized this retention of common ownership and the perpetuation of a few large concerns. The judges, however, held that the new situation would not be subject to successful prosecution, that the court was concerned with law and not economics, and that the remedy granted exhausted their power.[63] Political opponents of the Taft administration saw in Attorney General Wickersham's refusal to appeal the decree to the Supreme Court a sign of weak hypocrisy in the much-advertised trust-busting campaign. In this field, too, the long-term result has been an industry dominated by a few leaders (the "Big Four" in cigarettes), with very heavy advertising but relatively little price competition. A somewhat similar dissolution was ordered in the *Du Pont* case. No attempt has been made to produce a more perfectly competitive situation than in these cases, and the difficulties of doing so without sacrificing the economies of large-scale, integrated production may well be insuperable. Where a combination has already concentrated the physical process of production in one or two plants, as in the case of the Shoe Machinery Corporation, even limited dissolution would offer serious difficulties. A government victory in the current suit against the Aluminum Company would again raise in an acute form the problem of effective techniques of dissolution.[64]

The net effect of judicial construction of the Sherman Act under the rule of reason, and of Congressional acquiescence, was a substantial abandonment of the frontal attack on monopolistic close consolidations. The law prevented complete monopolization of certain industries and doubtless deterred attempts to monopolize others. After the *Steel* decision, however, it had no application to dominant firms falling short of complete monopoly. The emphasis was placed almost exclusively not upon the economic results of in-

[63] 191 Fed. 371 (1911).

[64] See D. H. Wallace, *Market Control in the Aluminum Industry* (1937).

dustrial concentration, as seen in an industry's price and output policy, but upon intent to control the industry unfairly, as evidenced by predatory practices against independents. Thus, the statute was transmuted from an antitrust law in the literal sense into a law against unfair methods of competition. Moreover, until very recently there has been no substantial political pressure to restore its original purpose. Democratic Party platforms have regularly repeated variations on their old watchword, "a private monopoly is indefensible and intolerable." The Republican Party, after making no positive declarations on the issue from 1920 to 1932, adopted that very phrase in 1936. A few leading figures in public life, like Senator Borah, consistently pled for rigorous enforcement of the law in its literal sense, but their voices were few in a wilderness of opponents. Serious efforts to revive effective government action against market control in any form have again become possible only in the last few years, when concentration of industrial power has been widely envisaged as a potent factor in one of the leading political issues of the day—the cause and cure of cyclical economic depression and secular unemployment.

Chapter Fourteen. THE FEDERAL TRADE COMMISSION AND THE REGULATION OF TRADE PRACTICES

American antitrust policy has been directed primarily toward the maintenance of competition through prohibition of monopoly and restraint of trade. A closely allied development has been designed to temper the effects of unbridled competition by confining the competitive struggle within a framework of established rules. Such regulation is, in principle, not strictly within the antitrust concept; it takes for granted the existence of competition and applies alike to small "chiselers" and to dominant enterprises threatening monopolistic control. In the historical unfolding of public policy in this country, however, the two types of regulation stemmed from the same roots and have remained closely intertwined.

The earliest competitive practices attacked by federal statute were considered undesirable first and foremost because of their use by large concerns to eliminate smaller rivals. Except for limited efforts to protect consumers against dangerous fraud, particularly in the food and drug fields, it was assumed that if the maintenance of competition were assured, the end product would be an economic order in the public interest. Only in recent years have legislatures been induced to strike out into wider territory to fix a basic plane of legitimate action and to forbid practices deemed "cutthroat," "ruinous," or "unfair." At the same time, the familiar regulatory machinery of statutory prohibition, enforced through private lawsuit or through civil or criminal action brought by the public prosecutor, has been supple-

mented by a newer governmental technique. The Federal Trade Commission, a bipartisan, permanent, specialized, semi-independent administrative tribunal, was designed to aid in both formulation and execution of trade regulation policy. The Commission was created to stand among the welter of special interests as a firm and unbiased protagonist of the true general welfare.

1. Competitive Practices at Common Law and Under the Sherman Act

It is of the essence of competition for one competitor to try to obtain the custom of his rivals. If he succeeds by virtue of superior efficiency or other legitimate advantage, they have no legal remedy for the damage suffered. Certain types of practices, however, have long been condemned at common law as against elementary standards of common morality. The term "unfair competition" was first applied to "passing off," or misrepresentation of the goods of one competitor as those of another. By adept simulation of a corporate name, a trade name, or a style of packaging, an unknown firm might trade on the good will built up by an established rival, and the courts would both give damages and enjoin the continuance of the deceptive device. Similar relief could be obtained when competitors engaged in malicious disparagement of one's business reputation or goods, or when they molested one's employees in the conduct of the business. Trade secrets were protected to some extent from commercial espionage and from divulgence by trusted ex-employees in service elsewhere.

By gradual extension of the concept of "unfair competition," the law came also to forbid enticement of a competitor's employees with intent to do him injury, or inducing breach of his contracts for sale by fraud, intimidation, or coercion. Malicious threats of patent or trade-mark infringement suits against a competitor's customers, with no real intent to carry out the threats in the courts, were similarly forbidden. Malice or fraud were at the heart of these offenses. They affected large and small enterprises alike, and the ordinary process of private civil lawsuit sufficed to deal with them. Some, like "passing off," might constitute a fraud on the consuming public as well, but the public's interest was considered secondary and capable of adequate protection by a just regard for the rights of those directly concerned.

With the growth of the combination movement in the latter part of the nineteenth century, new practices appeared which were also thought by many to be unfair. Not always immoral in themselves, they were considered objectionable because of their peculiar suitability for the destruction of competitors by large firms seeking to dominate an industry. Some of these practices could be used effectively only by powerful units. Commonly referred to as "predatory practices," they included attacks on small rivals through local price cutting, which could be financed out of high profits elsewhere, or through the use of "fighting brands," which were sold at a loss in order to destroy the market for a particular competing product. Railroad rebates or other transportation favors, the use of bogus independents (firms ostensibly independent but actually controlled by a combination), exclusive dealing contracts with local distributors, "tying" contracts requiring the use of a full line of goods in connection with a single patented or otherwise monopolized commodity, and measures by a dominant firm or group of firms designed to restrict the channels of distribution to certain favored dealers or types of dealer—all such practices were likewise viewed as "predatory."

Against these devices the common law was poor protection to the small competitor, both procedurally and substantively. In a contest between equals, private litigation might suffice to establish their respective rights, but the small man could not afford a lawsuit against a rival with sufficient economic power to destroy him. Moreover, the substance of the law failed to keep pace with the development of new techniques for eliminating competition. Predatory practices short of fraud upon particular competitors could not be attacked. Moreover, the price policy of any business not "affected with a public interest," however destructive to others, was solely within its own discretion.

The common law was supplemented to some extent by the Sherman Act of 1890. In its application to mergers, as has been seen, that law became focused upon predatory practices as evidences of restraint of trade and intent to monopolize. From 1911 on, decrees under the Act, including consent decrees, frequently outlawed the use of specific competitive devices. The effect of the statute in this connection is well illustrated by the opinion of a court in a dissolution suit in 1913, against a combination of towing companies on the Great Lakes:

Even competitive practices, of a nature which as between business rivals standing practically on equal terms may be normal and lawful, yet when employed by a powerful monopolistic combination with the ability to crush, and for the purpose of crushing, a weak rival, may become abnormal and unlawful. It needs no discussion to demonstrate that complete unification of the towing and wrecking facilities at fourteen principal ports, accompanied by restraints with respect to competition imposed upon the sellers of towing properties in excess of the legitimate protection necessary to the preservation of the business purchased, excessive restrictions against competition under joint contracts and on sales of tugs, bitter rate wars, and a system of exclusive contracts with customers such as is found here, all adopted or engaged in for the purpose of effectuating monopolistic control, are abnormal methods of doing business and eliminating competition, and that a restraint of natural competition by such means is undue restraint.[1]

Among the practices sometimes forbidden under the Sherman Act were excessive price cutting and local price discrimination when clearly intended to eliminate competition, bogus independents, "fighting brands" and the corresponding "fighting ships" (operated by shipping conferences against independents), "tying contracts," and contracts for exclusive dealing.

In particular, the law was applied to concerted efforts to restrict the channels of distribution. In the mid-nineteenth century, most commodities were distributed to ultimate consumers through a hierarchy of manufacturers, jobbers, wholesalers, and retailers. With increasing impetus since the beginning of the present century, a movement has arisen to integrate various stages in this process, either backwards or forwards. Manufacturers seeking a nation-wide or international market for their products have engaged in extensive advertising of branded goods to develop good will, and have frequently sought to establish direct contacts with retail outlets. In the automobile and gasoline industries and elsewhere, retailers are now generally exclusive and closely supervised dealers for particular manufacturers. Office typewriters are sold through legal agents of the manufacturer. On the other hand, department stores, chain stores, and mail-order houses have integrated the distributive process backwards, buying direct from manufacturers and selling direct to consumers.

[1] *United States* v. *Great Lakes Towing Co.*, 208 Fed. 733, 744 (1913).

Partial or total condensation of the traditional intermediate stages, with the corresponding threat to vested interests, has raised bitter resentment among groups of middlemen fearing elimination; they have taken strong measures to resist further change. Some of these measures were banned at an early stage under the Sherman Act. Wholesalers' associations were forbidden to boycott manufacturers who sold direct to retailers, or to circulate black lists and white lists with this object in view. Retailers were likewise enjoined from concertedly boycotting wholesalers or manufacturers who sold direct to consumers. The individual firm's right to buy and sell its goods from whom and to whom it pleased was in no way circumscribed, but joint and concerted agreements were held to be contracts or combinations in restraint of trade.

A more controversial issue was raised by manufacturers' efforts to prevent price cutting of their products when sold at retail. Those favoring the practice claimed that the good will created for a branded product by extensive advertising was depreciated by irresponsible price cutting. In some cases independent retailers refused to deal in a commodity on which the price was severely cut by chain stores or other mass distributors. Manufacturers, therefore, felt themselves entitled to protect their distributive outlets by contracts imposing resale price maintenance upon dealers further down the line toward the consumer. In this stand they were warmly supported by retailers of the traditional hierarchy, who saw in resale price maintenance an opportunity to maintain their status against the chain store, department store, and mail-order house. In some trades, notably drugs and groceries, independent retailers were the chief proponents of maintenance arrangements, frequently attempting to force them upon manufacturers. The independents charged that price cutting on nationally advertised goods was often used by rivals as a bait or "loss leader" to persuade customers to enter the store, whereupon they would be sold other goods at excessive prices. On the other side of the argument, mass distributors thought maintenance contracts an unwarranted interference with their price policy over goods which they owned. They contended that it was both legitimate and desirable to attract custom through the price reductions made possible by superior distributive efficiency. Price maintenance, they claimed, was an attempt to freeze the old-established channels of distribution in the interests of the less efficient.

Early state court decisions on this subject were in conflict. Some

held that price maintenance contracts were invalid as restraints of competition among retailers and, therefore, opposed to public policy. Others upheld such contracts where the fixed price was on a product subject to substantial competition from similar goods. The dispute reached the Supreme Court in 1911, where it was resolved against the practice. Uniform manufacturers' contracts with distributors were likened to a direct price-fixing agreement among the latter, and it was held that the "public is entitled to whatever advantages may be derived from competition" in retailing.[2] Subsequent decisions applied the rule to patented articles. Exceptions were made only for mere announcement of desired prices coupled with a refusal to sell to distributors not maintaining them, without contracts or other express or implied agreements.[3] A manufacturer distributing through bona fide agencies and retaining title of the goods until their final sale could, of course, fix retail prices as he pleased.[4]

Application of the Sherman Act to specific competitive practices left considerable dissatisfaction among various groups. Victims of predatory methods felt that the law should intervene before the methods had taken effect. Instead of condemning their future use only after the damage had been done, public policy might thus forestall attempted monopoly before it had taken root. In some instances it was felt that the courts had not gone sufficiently far. Tying contracts and exclusive dealing arrangements, for example, were sometimes upheld as legitimate extensions of patent rights. The permissible limits of price discrimination between localities or between different types of customers were uncertain. Dissatisfaction was crystallized into outright criticism and strong pressure for amendment after the *Standard Oil* and *American Tobacco* decisions of 1911. Recognizing for the first time that the law unquestionably had significant teeth, businessmen urged a more rigorous definition of forbidden acts. The rule of reason seemed to many to leave to the courts excessive discretion in condemning or approving business practices. Moreover, antitrust decrees covered a number of specific practices in each instance, and it was impossible to know whether any given practice

[2] *Dr. Miles Medical Co.* v. *Park & Sons Co.*, 220 U.S. 373 (1911).

[3] *United States* v. *Colgate & Co.*, 250 U.S. 300 (1919); *United States* v. *A. Schrader's Son*, 252 U.S. 85 (1920); *Frey & Son* v. *Cudahy Packing Co.*, 256 U.S. 208 (1921); *FTC* v. *Beech-Nut Packing Co.*, 257 U.S. 441 (1922).

[4] *United States* v. *General Electric Co.*, 272 U.S. 476 (1926). It is often difficult to determine whether an agency agreement is, in fact, bona fide.

would be condemned if employed alone. Continuous agitation during the next few years, within and outside of Congress, culminated in 1914 in the passage of the first important supplementary antitrust legislation.

2. The Legislation of 1914

Two streams of thought lay behind the Federal Trade Commission and Clayton Acts of 1914. The first contemplated substantive modification of the old law, specifying prohibited practices and eliminating the uncertainty introduced by the rule of reason. The second desired new administrative machinery, a specialized body to aid in law enforcement, to supervise and apply guiding rules to the competitive system. If public policy were to distinguish between "good" and "bad" trusts, that judgment, it was felt, could not safely be left to a remote and uncontrolled judiciary, or to a busy Attorney General's office subject to direct political pressures. Distrust of the courts was a potent factor in that day, particularly in the Progressive wing of the Republican Party. These two streams of thought, however, were each the product of widely divergent attitudes.

Among supporters of the broad policy implied in the Sherman Act the immediate reaction to the *Oil* and *Tobacco* decisions, and more particularly to the supposed fiasco of the subsequent "dissolutions," was a desire to repeal the rule of reason and to replace in the Act uncompromising prohibitions against all attempted monopolies and restraints of trade. Well represented in Congress, although not organized in any coherent form in the country at large, this group also felt that the experience of two decades warranted extension of the statute to forbid specific practices and methods of organization which had been used time and time again to intimidate or absorb competitors. Its leaders included Louis D. Brandeis, Senator Cummins of Iowa, and Representatives Clayton of Alabama and Stevens of New Hampshire.

Much had been learned since 1890 about America's industrial organization and business practices. The Industrial Commission of 1899–1902, the Bureau of Corporations, the gigantic court records of antitrust prosecutions, and special Congressional investigating committees like the Stanley Committee of 1911, which made an elaborate inquiry into the history and operations of the United States Steel Corporation, had supplied an enormous mass of data upon which to

build new legislative policies. Price discrimination, fighting brands, bogus independents, transportation favors, tying contracts, and exclusive dealer arrangements were the predatory methods most often selected for attack. The holding company was singled out as a particularly objectionable form of organization. In addition, the findings of the Pujo Committee's investigation of the "Money Trust" in 1912 led many observers to the conclusion that bankers' control of industrial firms, implemented through interlocking directorates, was another threat to continued competition which must be specifically outlawed. If definitions along these lines were added to the Sherman Act, it was hoped, monopoly might be suppressed in its incipiency. The difficult task of unscrambling trusts could then be largely avoided. Brandeis put forward the thesis that big business was less efficient than enterprise on a moderate scale, that the contemporary growth of bigness was based largely upon artificial advantages, and that if government forbade such advantages natural forces could be relied upon to maintain healthy competition as a regulator of prices and output.

This group advocated a commission primarily in order to make antitrust law enforcement more efficient. It would be an enlarged and improved Bureau of Corporations, free from direct political control, which would engage in continuous surveys of business practices and investigations of allegedly monopolistic industries. It would turn apparent violators over to the Department of Justice for prosecution and aid the courts in working out plans for dissolution in order to bring about truly competitive situations. Only a few members of the group, notably Congressman Stevens, envisaged the commission as a device for building up an administrative law of unfair competition.

Leaders of the business community were, on the whole, more content with the rule of reason. On the other hand, the Sherman Act was now a proven potential danger, and few of them shared President Taft's confidence that the new interpretation could leave no one uncertain as to whether his practices were illegal.[5] Businessmen, too, sought more specific definitions of forbidden acts, but they were particularly anxious to be allowed to eliminate cutthroat or ruinous com-

[5] In 1911, the National Civic Federation circulated a questionnaire to leading businessmen containing the following question, among others: "Do you believe that the Sherman Law, as now interpreted, is made clear and workable?" Of 1,033 answers, 841 were in the negative and only 192 in the affirmative. Senate Committee on Interstate Commerce, *Hearings on the Control of Corporations*, 1911–12, p. 499.

petition. Judge Gary, of the Steel Corporation, went further than most, declaring:

> I would think in such times as the panic of 1907 the corporations engaged in the same line of business should, with the advice and under the direction of a commission, be permitted to come together and for a given period be permitted to co-operate to the extent of reducing their production to meet the demand, distributing it fairly between the different corporations, so that their employees, respectively, should have the same treatment, provided at the same time the commission should have the right to make the maximum price to be charged in order to protect the purchasing public; and I believe in all times that there should be permitted by a commission, and therefore by law, such co-operation amongst competing competitors, competing corporations, as would result in the promotion of the interests of all the competitors, and not the destruction of any of them, and to the extent that the purchasers of the commodities of those corporations would not be injured.[6]

In the eyes of this group, a new commission was desirable above all as a body to review in advance proposed mergers and other potentially illegal acts. Its approval was to immunize the participants against subsequent antitrust prosecutions. Some would have subjected commission decisions to judicial review, thus throwing the ultimate determination of policy back to the courts, but others were willing to leave final discretion in the hands of the commission. This proposal had been decisively rejected by the Senate in 1909, but it was now pushed forward with renewed fervor. Surprising numbers of businessmen were also ready to accept federal incorporation, or at least compulsory federal licensing, for interstate corporations, and even a degree of federal price regulation where near monopoly was the only alternative to cutthroat competition.

In addition to these two major competing viewpoints of antimonopolists and of business leaders, there was a whole range of more or less vociferously expressed opinion. It spread all the way from satisfaction with the Sherman Act as it stood to suggestions for encouragement of concentration in industries with heavy capital requirements, coupled with stringent regulation of the public utility variety. President Taft and his Attorney General, G. W. Wickersham, led the defenders of the *status quo*. A few voices indicated content with potential competition as an adequate safeguard against exploitation,

[6] *Ibid.*, pp. 816–817.

without any positive governmental action whatsoever. Far more important than such proposals were the demands of organized groups interested only in single phases of antitrust policy. The American Federation of Labor, which played a significant part in the 1912 campaign and was looked upon by the resurgent Democratic Party as an essential element of its strength, demanded complete exemption from the Sherman Act as well as restrictions on the use of injunctions in labor disputes. To this proposal the Federation added exemption for agricultural organizations, thus attempting to enlist the support of organized farmers. Legalization of resale price maintenance was advocated by retail druggists and certain manufacturers. Retailers and wholesalers in the grocery and lumber trades desired freedom to organize boycotts against manufacturers who sold direct to chain stores and other mass distributors.

It was in such a climate of opinion that Wilson's administration, backed by solid majorities in both Houses, began its serious attack upon antitrust law revision. Having dealt in 1913 with tariff and currency reform, it turned to trust legislation in the following year. The Democratic platform of 1912 "regretted" the rule of reason and demanded prohibition of holding companies, interlocking directorates, stock watering, price discrimination, and domination of any industry by a single corporation. Unlike both the Republican and Progressive platforms, the Democrats made no reference to a new trade commission, but President Wilson added this item to the program in his special antitrust message of January, 1914. In method of enactment, the resulting legislation contrasted strikingly with the 1890 Act. There had been extended hearings in 1911 and 1912, at which a Senate Committee gave ear to 103 witnesses, representing every variety of opinion in this field. Further hearings were held by committees in charge of the detailed proposals in the new Congress. A number of legislators, notably Senator Newlands of Nevada, had been refining the details of a Trade Commission Bill over a period of years. Instead of a brief and hurried measure pushed through its legislative stages with little attention from Congress and none from the executive, there was a group of proposals hammered out in months of debate, amendment, and reamendment, always under the careful eye of Wilson and his immediate advisers. Yet the final product was scrappy and incoherent—from the technical viewpoint a far more imperfect specimen of legislation than the Sherman Act itself.

Without originating any elements of the new statutes, President

Wilson himself dominated the choice of policy adopted. His own philosophy, expressed while serving as Governor of New Jersey and in a number of speeches during the Presidential campaign, roughly paralleled the Brandeis-Cummins viewpoint described above. To him, the worst vice of the trusts was their effect in preventing little men of enterprise and ingenuity but limited capital from making their independent way to success in the American system. He felt that "item by item we can put in *our statutes what constitutes restraint of trade,* not leaving it to courts for generalizations which may fit some cases and not others." [7] Under his guidance, several related bills were submitted, outlawing interlocking directorates, defining a number of acts to be deemed "in restraint of trade," prohibiting explicitly certain predatory competitive methods, and establishing a trade commission. In its original form the commission was essentially an enlarged and independent Bureau of Corporations. In the course of the summer, however, the proposal to specify in unequivocal terms all those predatory methods which lay at the base of successful monopolistic control of industry proved utterly chimerical.

No statutory definitions could ever be drawn to include the infinite flexibility of industrial and commercial life. As soon as one set of prohibitions was laid down, new methods, or new variations on old methods, would spring up to circumvent them. If the trust problem were really to be solved by catching monopolistic practices in their infancy, government would have to operate through constantly expanding administrative or judicial definition of a comprehensive legislative standard. Wilson was thus led to adopt and press forward Congressman Stevens's proposal to give the new commission authority to enforce a general prohibition of unfair methods of competition. The bills were finally fused into two, one dealing with the Federal Trade Commission and the other, named for Chairman Clayton of the House Judiciary Committee, grouping together a host of provisions, including prohibition of two specific types of trade practice. In ultimate passage the measures were supported by the great bulk of the Democratic Party, with the Progressive Republicans voting for them but urging their inadequacy, and the regular

[7] Italics in original. From address on "The Tariff and the Trusts," at Nashville, Tennessee, February 24, 1912, in R. S. Baker and W. E. Dodd (editors), *The Public Papers of Woodrow Wilson—College and State* (1925), Vol. II, p. 414.

Republicans opposing them as dangerous encroachments upon business freedom.

As established by the statute, the Federal Trade Commission was a body of five commissioners, holding office for seven years but with their terms so arranged that only one would expire in any year. Not more than three might be drawn from the same political party. Salaried at $10,000, they were placed in a position of substantial independence from the ordinary executive departments and might be removed by the President only for "inefficiency, neglect of duty, or malfeasance in office." [8] They absorbed the personnel and functions of the Bureau of Corporations and were given even wider investigatory powers. On application from the Attorney General, or on their own initiative, they might investigate the effectiveness of antitrust decrees, and, upon request by a court, act as master in chancery in recommending the form of new decrees after successful prosecutions.

The substantive power of the Commission was derived from Section five of the Act, which stated: "That unfair methods of competition in commerce are hereby declared unlawful." After formal complaint, notice, and hearing, the Commission might order persons, partnerships, or corporations engaging in such methods to "cease and desist." Until 1938, legal sanction for enforcement depended upon review and approval by a circuit court of appeals, upon the initiative either of the defendant or of the Commission itself. Violation of the order would then constitute contempt of court and be punishable as such. In 1938, for reasons indicated below, the terms of Section five were amplified to include "unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce." In addition, Commission orders to "cease and desist" became final sixty days after their issuance, unless the defendant petitioned meanwhile for judicial review. Violation now entails a civil penalty of up to $5,000.[9]

Commission jurisdiction over enforcement of this general competitive standard was made exclusive. It shared with the Department of Justice responsibility for enforcing the four specific prohibitions of the Clayton Act. Section two of the latter statute forbade price discrimination among purchasers where the effect "may be to substan-

[8] See *Rathbun* v. *United States,* 295 U.S. 602 (1935).

[9] This change in procedure applies only to orders under Section 5 of the FTC Act, but not to orders under Sections 2, 3, 7, or 8 of the Clayton Act.

tially lessen competition or tend to create a monopoly in any line of commerce," except for discrimination on account of differences in grade, quality, or quantity, or making due allowance for selling or transportation costs, or "in good faith to meet competition." [10] Section three outlawed tying contracts and exclusive dealing arrangements, or price concessions to the same effect, likewise where the effect "may be to substantially lessen competition or tend to create a monopoly in any line of commerce." Intercorporate stock acquisitions, except among railroads, were forbidden by Section seven, where the effect "may be to substantially lessen competition" *between the corporations concerned,* or tend to create a monopoly of any line of commerce. In Section eight, finally, the Clayton Act prohibited interlocking directorates among banks with over $5,000,000 capital or among competing industrial corporations with over $1,000,000 capital. The remainder of the Act dealt with minor procedural reforms, with railroads, and with relief of organized labor from the antitrust laws and from certain types of injunctions in the course of industrial disputes.[11]

The 1914 legislation added little to the substance of the law, outside of the seemingly sweeping provision of the Federal Trade Commission Act against unfair methods of competition. In a succession of decisions, the Supreme Court has whittled away the Clayton Act's prohibitions of intercorporate stockholding to utter impotence. A group of three cases in 1926 made it clear that direct violation of the law through acquisition of stock control in a leading competitor would be enjoined, but if the defendants had used their illegally acquired controlling interest to effect a merger of physical assets prior to the suit, the law provided no remedy.[12] Four justices dissented from this latter doctrine. Even the mild discouragement to holding company control which remained was later destroyed by judicial interpretation. In 1930 the International Shoe Company, largest manufacturer in the country, was allowed to retain control of the W. H. McElwain Company, ranking fourth or fifth.[13] The companies were held to be noncompeting because they dealt in different types of

[10] This section was amended by the Robinson-Patman Act of 1936. See below, pp. 599–602.

[11] For a discussion of the labor provisions of the Clayton Act, see above, pp. 154–156.

[12] *FTC* v. *Western Meat Co., Thatcher Manufacturing Co.* v. *FTC, Swift & Co.* v. *FTC,* 272 U.S. 554 (1926).

[13] *International Shoe Co.* v. *FTC,* 280 U.S. 291 (1930).

shoes generally sold to different classes of consumers, although dress shoes made by both went into the same geographical market areas. Prospective bankruptcy of the McElwain Company also played a part in the decision. Moreover, stress was laid on the continuance of outside competition, although the law specifically condemned elimination of competition between the companies concerned and omitted the requirement of a tendency to lessen competition in general or to promote monopoly.[14]

A five to four decision in 1934, finally, validated a merger of assets executed by a holding company after a formal complaint had been issued against it under the Act.[15] In the words of Justice Stone, dissenting, "It is now declared that, however gross the violation of the Clayton Act, however flagrant the flouting of the [Federal Trade] Commission's authority, the celerity of the offender, in ridding itself of the stock before the Commission could complete its hearings and make an order restoring the independence of the competitors, leaves the Commission powerless to act against the merged corporation." Recent changes in court personnel will probably alter this latter extreme stand. Nevertheless, it is clear that the Clayton Act as it stands affects mergers only if intercorporate stockholding is perpetuated as the means of control; and the Act exempts those outright fusions which employ the forbidden means only as a step in their formation. The Federal Trade Commission has for some years recommended extension of the Act to forbid intercorporate stock *and asset* acquisitions tending toward monopolistic conditions.[16] In a recent bill to this effect, 10 per cent of the output of any industry would be fixed as the limit for new mergers of any sort.[17]

Section eight of the Clayton Act, outlawing interlocking directorates, has brought about a few resignations. It is so open to evasion through the use of dummy directors, however, that it is of no real

[14] Cf. also *V. Vivaudou, Inc.*, v. *FTC*, 54 F. (2d) 273 (1931); *Temple Anthracite Coal Co.* v. *FTC*, 51 F. (2d) 656 (1931); *United States* v. *Republic Steel Corp.*, 11 F. Supp. 117 (1935); *Pennsylvania R.R. Co.* v. *Interstate Commerce Commission*, 66 F. (2d) 37 (1933).

[15] *Arrow-Hart & Hegeman Electric Co.* v. *FTC*, 291 U.S. 587 (1934).

[16] This recommendation was repeated in strong terms in consequence of the Agricultural Implement and Machinery Inquiry of 1936–38, from which the Commission concluded that a serious monopolistic condition had been brought about in this industry by virtue of frequent purchases of competitors' assets. H. Doc. 702, 75th Cong., 3rd Sess. (1939), p. 1038.

[17] H.R. 10176, 75th Cong., 3rd Sess. (1938).

importance. Sections two and three, the only remnants of the original program of detailing predatory competitive methods, were largely robbed of their vigor by the qualifying phrases, "where the effect may be substantially to lessen competition or tend to create a monopoly in any line of commerce." For while they attempted in terms to fix two elements in the basal plane of competition, they were thereby limited to instances already likely, for the most part, to fall within Sections one and two of the Sherman Act. Regulation of competitive practices was still being treated as subordinate to the preservation of competition itself.

If the intensive legislative effort were to bear any fruit, it had to be through the newly established Federal Trade Commission and such administrative law as it might develop. Contemporary students looked upon this as the real contribution of 1914. One of them described the Trade Commission Act as "an important step in the direction of eliminating those [unfair] practices and therefore toward the ultimate solution of the trust problem." [18] These expectations were destined to disappointment.

3. Trade Regulation Under the Clayton Act

EXCLUSIVE DEALING

Neither Section two nor Section three of the Clayton Act has been wholly without effect upon the law or upon trade policy. Section three deals with two essentially different, although related, practices. Exclusive dealing arrangements restrict a wholesale or retail dealer to the sale of one manufacturer's products only, within a given field. Thus a coffee manufacturer might enter into contracts with a chain grocery forbidding the latter to sell competing brands of coffee. Such arrangements carry with them monopolistic implications only where the manufacturer is of outstanding importance in his industry, with consequent power to force acceptance upon many dealers and thus shut off a substantial array of outlets from lesser competitors. Under other circumstances the use of exclusive dealing contracts may be viewed, like resale price maintenance, simply as a partial vertical integration of the distributive process, giving the manufacturer added control over his outlets and added assurance that they will persistently press for sales of his product. Exclusive dealing in a reverse

[18] W. H. S. Stevens, "The Trade Commission Act," 4 *American Economic Review* 840, 854 (December, 1914).

sense is sometimes demanded by large manufacturers from their own suppliers of patented machinery, in order to impede effective manufacturing competition.

The practice had been sanctioned before 1914 as not constituting in itself a restraint of trade within the meaning of the Sherman Act,[19] but in several cases it was outlawed as one part of a monopolistic scheme carried on by a dominant producer or combination.[20] By singling out exclusive dealing for special attention in the Clayton Act, Congress induced the courts to view it with slightly less favor, but the practical consequences of the alteration have been very slight. In the leading case on this aspect of Section three, *Standard Fashion Co.* v. *Magrane-Houston Co.*, the Supreme Court stated:

> The Clayton Act sought to reach the agreements embraced within its sphere in their incipiency, and in the section under consideration to determine their legality by specific tests of its own. . . .
>
> Section 3 condemns sales or agreements where the effect of such sale or contract of sale "may" be to substantially lessen competition or tend to create monopoly. It thus deals with consequences to follow the making of the restrictive covenant limiting the right of the purchaser to deal in the goods of the seller only. But we do not think that the purpose in using the word "may" was to prohibit the mere possibility of the consequences described. It was intended to prevent such agreements as would under the circumstances disclosed probably lessen competition, or create an actual tendency to monopoly. That it was not intended to reach every remote lessening of competition is shown in the requirement that such lessening must be substantial.[21]

In this instance, a dress-pattern company controlling two fifths of the industry was forbidden to limit merchants to exclusive sale of its patterns. On the other hand, such relative predominance has been held essential to bring a manufacturer within the law.[22] The Federal

[19] *In re Greene*, 52 Fed. 104 (1892); *Whitwell* v. *Continental Tobacco Co.*, 125 Fed. 454 (1903); see also *D. R. Wilder Manufacturing Co.* v. *Corn Products Refining Co.*, 236 U.S. 165 (1915).

[20] Cf. Commissioner of Corporations, *Trust Laws and Unfair Competition* (1915), pp. 484–486; *Continental Wallpaper Co.* v. *Voight*, 212 U.S. 227 (1909); *Standard Sanitary Manufacturing Co.* v. *United States*, 226 U.S. 20 (1912); *United States* v *Great Lakes Towing Co.*, 208 Fed. 733 (1913) and 217 Fed. 656 (1914).

[21] 258 U.S. 346, 356–357 (1922).

[22] *In Q.R.S. Music Co.* v. *FTC*, 12 F. (2d) 730 (1926), exclusive dealing contracts were forbidden to a company controlling over half the player-piano music-roll industry.

Trade Commission was reversed in 1923 when it directed one of sixty-five margarine manufacturers, producing slightly over 1 per cent of the country's output, to give up its exclusive dealer contracts; in this case the Court could see no likelihood of lessened competition or tendency to monopoly.[23] A bona fide system of agencies, where title to the goods remains with the manufacturer until sale to the ultimate consumer, is, of course, also exempt from this provision. The courts show much sympathy toward manufacturers who have invested time, money, and ingenuity in building up a novel type of sales organization.[24] The Commission has issued only a few final orders against exclusive dealing since 1924.[25]

TYING CONTRACTS

A more noteworthy alteration in the law was produced by Section three of the Clayton Act in connection with tying arrangements. This practice, sometimes known as "full-line forcing," makes the lease or sale of a particular product conditional on the lessee's or purchaser's use of associated products made by the same manufacturer. It is effective only where patent monopoly, exclusive control of a raw material, or unusual good will among consumers gives to the primary product some unique desirability; it then serves to extend a partial monopoly into a wider field. The classic example is found in the United Shoe Machinery Company's leasing arrangements, described in Chapter 13, which were directly responsible for the clause in the Clayton Act.

The statute applies in terms to commodities "whether patented or unpatented." In 1912, the Supreme Court by a four to three decision had allowed the A. B. Dick Company to compel purchasers of its patented mimeographs to use on the machines only ink and paper supplied by itself.[26] While this decision was reversed in 1917 without dependence upon the Clayton Act,[27] the reversal applied only to cases where title to the patented article was transferred by sale, and

[23] *B. S. Pearsall Butter Co.* v. *FTC,* 292 Fed. 720 (1923). Cf. also *Excelsior Motor Mfg. & Supply Co.* v. *Sound Equipment, Inc.,* 73 F. (2d) 725 (1938).

[24] *FTC* v. *Curtis Publishing Co.,* 260 U.S. 568 (1923).

[25] For a recent order of this type which was affirmed by the courts, see *Carter Carburetor Corp.* v. *FTC,* 112 F. (2d) 722 (1940).

[26] *Henry* v. *A. B. Dick Co.,* 224 U.S. 1 (1912).

[27] *Motion Picture Patents Co.* v. *Universal Film Manufacturing Co.,* 243 U.S. 502 (1917).

not to leasing arrangements of the sort used by the Shoe Machinery Company. The latter's tying leases were successfully attacked only on the basis of the Clayton Act's specific prohibition,[28] which has thus substantially reduced the scope of patent protection to dominant firms.

Here, too, however, monopolistic tendency or substantial lessening of competition is essential to the offense, and the courts apply the Act only when a manufacturer predominates in his field. The Shoe Machinery Corporation controlled over 95 per cent of the business. In the most recent Supreme Court case, two manufacturers of electric tabulating machines who supply the entire market were enjoined from requiring exclusive use of their own tabulating cards, although they may protect their good will by warning against the use of inferior cards.[29] The Radio Corporation of America, doing between 70 and 95 per cent of the business in radio tubes, was likewise forbidden to require radio manufacturers, licensed to use its patented circuits, to buy from RCA all vacuum tubes needed for initial operation of the sets.[30]

On the other hand, the General Motors Corporation has been sustained in requiring its Buick and Chevrolet agents to use in repair work only its own replacement parts, both as a reasonable protection of its good will and because competition in replacement parts is substantial. Hindrance to potential competition was admitted, but held beyond the scope of the Act.[31] In its most ambitious action under Section three, the Federal Trade Commission ordered thirty-five gasoline refiners to cease leasing roadside pumps at nominal rentals on condition that only their own brands of gasoline be sold from such pumps. No obstacle was set up against a single dealer carrying several brands, as long as he obtained a separate pump for each, but the Commission contended that in practice most lessees would not find it worth their while to do so. In the courts this stand was decisively rejected. Judicial emphasis was placed on the large number of refiners seeking to supply the retailer, and on the absence of any

[28] *United Shoe Machinery Corp.* v. *United States*, 258 U.S. 451 (1922).

[29] *International Business Machines Corp.* v. *United States*, 298 U.S. 131 (1936).

[30] *Lord* v. *RCA*, 24 F. (2d) 565 (1928); affirmed in 28 F. (2d) 257 (1928); *cert. den.*, 278 U.S. 648 (1928). Cf. also *Stanley Co. of America* v. *Am. Tel. and Tel. Co.*, 4 F. Supp. 80 (1933); *Oxford Varnish Corp.* v. *Ault and Wiborg Corp.*, 83 F. (2d) 764 (1936).

[31] *Pick Manufacturing Co.* v. *General Motors Corp.*, 80 F. (2d) 641 (1935); affirmed in 299 U.S. 3 (1936).

indication of lessened competition, as well as on the desirability of protecting the public from deception.[32]

The somewhat similar practice in the motion-picture industry of requiring independent exhibitors to lease films in blocks has been attacked by the FTC under Section five of the Trade Commission Act. The Commission was again reversed in the courts because of the number of active competitors in the field, no single one of whom was predominant. Six very large and two substantial producer-distributors shared among them 98 per cent of the American industry, Paramount alone holding 12 per cent at the time of the suit. While it is evident that block booking both hinders the growth of new producers and restricts the freedom of the exhibitors to select from the industry's entire product, this situation was viewed by the Circuit Court in 1932 as freely competitive and well beyond the reach of the anti-trust laws.[33] In the recent revival of antitrust activity, the practice has again been under attack from the Department of Justice.[34]

It is a far cry from the hopeful intent of 1914, of stifling monopoly in its incipiency, to the practical effect of this substantive addition to the law. The courts have construed the words "to substantially lessen competition or tend to create a monopoly" very narrowly, preferring in all but extreme cases to conserve the entrepreneur's right to conduct his business as he pleases. The legal standard has given insufficient weight to the economic effects of imperfect competition upon an industry's price and output policy. In a recent investigation of the agricultural machinery industry, for example, the Federal Trade Commission reported that full-line forcing, coupled with

[32] *FTC* v. *Sinclair Refining Co.*, 261 U.S. 463 (1923). Cf. also *Auto Acetylene Light Co.* v. *Prest-O-Lite Co.*, 276 Fed. 537 (1921); *Lipson* v. *Socony-Vacuum Corp.*, 7 F. Supp. 961 (1934); 76 F. (2d) 213 (1935).

[33] *FTC* v. *Paramount Famous Lasky Corp.*, 11 FTC 187 (1927); 57 F. (2d) 152 (1932). For several years a number of civic groups, led by the Motion Picture Research Council and various associations of independent exhibitors, have sought to prohibit block booking and the associated practice of "blind selling" by Act of Congress. The Neely-Pettengill Bill to this effect (S. 153) was passed by the Senate in the 75th Congress, 3rd Session, but was too late for consideration by the House. It also failed to pass in the 76th Congress.

In *FTC* v. *Gratz*, 253 U.S. 421 (1920), the Commission was also reversed by the courts in an attack on a tying contract under Section five of the FTC Act. In this instance the facts warranted a showing of dominance over the industry concerned, but the Commission had failed to allege monopolistic tendency or purpose. The reversal was based on this narrow procedural issue.

[34] See below, p. 540.

pressure for exclusive dealing, "has extensive adverse effects upon the interests of smaller manufacturers, retailers, and farmers." [35] Although the practice is not universal, manufacturers who do not supply a full line are often prevented from using established dealers in smaller communities, and cannot afford to set up separate outlets. Yet it is very unlikely that this situation could be successfully attacked under either the Clayton or the Federal Trade Commission Acts as now interpreted, since there are five important firms in the field and the largest, International Harvester, produces only about 55 per cent of the total output.

PRICE DISCRIMINATION

Section two of the Clayton Act, the provision against price discrimination, was hedged about with even more exceptions than Section three. In its original form it not only required proof of tendency to lessen competition or create a monopoly, but it also specifically permitted discrimination on account of differences in grade, quality, or quantity, when making only due allowance for differences in selling or transportation costs, or "in good faith to meet competition." Without doubt, the salient practice which Congress sought to outlaw was temporary local price cutting by a firm with large resources, as a means of eliminating a weaker (but not necessarily less efficient) competitor. An earlier version of the Section referred to lessening of competition between purchasers of the commodity concerned as well as in the sellers' line of commerce. Thus, some desire was indicated to eliminate unwarranted favoritism on the part of a seller of raw materials or some other strategically located firm, with possible monopolistic consequences further down the line toward the consumer.[36] This latter consideration was secondary, however. Examples of undesirable discrimination were almost always drawn from the predatory price-cutting tactics of Standard Oil and its subsidiaries, the Tobacco Trust, the National Cash Register Company, and other more or less notorious combinations around the turn of the century.

In practice, the Section has been little used in this connection. Predatory local price cutting appears to have declined in popularity

[35] FTC, *Report on the Agricultural Implement and Machinery Industry,* 1938, H. Doc. 702, 75th Cong., 3rd Sess., pp. 21, 268–288, 1024–1025.

[36] As far as railway rates were concerned, discrimination had been forbidden by the Interstate Commerce Act and subsequent legislation described in Chapter 9.

as a competitive weapon. The decline may be ascribed in part, doubtless, to the existence of the Clayton Act, but is probably more largely due to the development of subtler techniques of price control, carried on in co-operation with former competitors. The initiator of a price war, moreover, always runs the risk of its extension to his entire market. In the only important case of this type to go to court, the Porto Rican American Tobacco Company secured an injunction against the American Tobacco Company, prohibiting the latter from continuing a disastrous campaign of low-price cigarette sales on the island.[37]

BASING-POINT SYSTEMS

Geographical discrimination of another order, not foreseen in 1914, has received the prime attention of the Trade Commission under Section two. It is a result of the so-called "basing-point system," a method of charging uniform delivered prices for commodities. The basing-point system first came into prominence in the steel industry, but it has also been widely adopted for other metals, lumber, cement, and similar bulky commodities on which transportation charges are heavy. In its simplest form it may be illustrated by the "Pittsburgh Plus" scheme employed before 1924 by the United States Steel Corporation, and followed by the remainder of the steel industry. Prices for steel, no matter where produced or how delivered, were fixed as the sum of a Pittsburgh "base price" and the rail freight charge to the point of delivery. Thus, a Chicago fabricator buying from a Chicago steel mill paid a "Pittsburgh Plus" price regardless of Chicago costs of manufacture and despite the absence of actual transportation charges. Price competition was thus eliminated at all points, producers outside Pittsburgh either "picking up" or "absorbing" differences between actual freight charges and charges from Pittsburgh. The system implied willingness of non-basing-point producers (other than United States Steel Corporation mills) to refrain from price cutting in their own areas, but fear of retaliation by a gigantic opponent and the compensatory opportunity of entering distant markets evoked their support. As important fabricating centers developed outside of Pittsburgh, however, steel consumers in the West became

[37] *Porto Rican American Tobacco Co.* v. *American Tobacco Co.*, 30 F. (2d) 234 (1929). The Federal Trade Commission has not issued an order against this type of practice since 1921.

increasingly resentful at payment of mythical transportation charges. Pressure was consequently brought on producers, on state legislatures, and on the Federal Trade Commission to secure some modification of the practice.

In 1924, after elaborate investigation and proceedings lasting for several years, the Commission issued an order finding the Steel Corporation and its subsidiaries guilty of violation of Section two of the Clayton Act, and directing them to abandon "Pittsburgh Plus."[38] Instead of contesting the order in court, the Corporation announced its intention of complying "in so far as it is practicable to do so."[39] A multiple basing-point system was substituted, providing several bases for each category of steel products, but many producers remained at non-basing-points. Base prices at the new points, moreover, were generally considerably higher than at Pittsburgh. The modified system was temporarily legalized, with some changes, under the National Industrial Recovery Act of 1933, but was bitterly attacked in two reports of the Trade Commission.[40] Legislation specifically outlawing the practice was introduced into Congress in 1936 and 1937 but was not pressed to a vote.[41] The legality of basing-point systems under existing statutes[42] is now being tested in formal actions by the Commission against manufacturers of cement and of cast-iron soil pipe.

It is evident that any absorption or "pick-up" of freight charges for mythical transportation involves geographical discrimination in an economic sense. Multiple basing points reduce the amount of discrimination, but even a "mill-base" system, where every mill is a basing point, does not wholly eliminate discrimination as long as producers are willing to absorb freight and thus compete in price

[38] *FTC* v. *U.S. Steel Corp.*, 8 FTC 1 (1924).

[39] In 1938, passage of the Wheeler-Lea Amendment to the Federal Trade Commission Act made all prior Commission orders automatically enforceable unless appealed to the courts within sixty days. The Steel Corporation immediately appealed the order of 1924. At the end of 1940, no court decision in this case had yet been handed down.

[40] FTC, *Practices of the Steel Industry Under the Code*, 1934, S. Doc. 159, 73rd Cong., 2nd Sess.; *Report to the President with Respect to the Basing Point System in the Steel Industry*, 1934.

[41] Under informal pressure from various federal agencies, including purchasers on government account and the President himself, the U.S. Steel Corporation announced in 1938 that mill-base prices at Pittsburgh, Chicago, and Birmingham will henceforth be identical.

[42] The amendment of Section two by the Robinson-Patman Act of 1936 is probably of no significance in this connection.

in the local areas of others. This latter practice is clearly "in good faith to meet competition," and hence not in violation of the Clayton Act. On the other hand, as long as any mills are not located at basing points, fabricators in their neighborhood are at a disadvantage. Where the differential in base prices is at variance with cost differences between the respective mills, there is a corresponding disadvantage to fabricators in the high base-price area.

While an industry has unused capacity, it is possible that the basing-point system improves utilization of basing-point mills sufficiently to reduce over-all costs to the benefit of producers and consumers alike.[43] The Federal Trade Commission, however, stresses the consequences in uneconomic location of industry, absorption by producers of the advantages of transportation methods other than rail, wasteful cross-freighting, and wastes in costs of selling beyond an economic area around a given mill. More particularly, the Commission argues that the practice facilitates illegal price agreements among producers, and points to the maintenance of constant differentials between base prices as evidence for this viewpoint.[44] If the Commission can show that the system results in substantial hindrance to competition among fabricators, or contributes substantially to price-fixing collusion among producers, it will apply Section two for the first time to an important and widespread practice in the productive phase of the American economy.

DISCRIMINATION IN THE CHANNELS OF DISTRIBUTION

By an unforeseen chance, Section two has been employed most frequently against discrimination in the course of distribution. It has become a weapon in the struggle, already mentioned, between alternative distributive channels. Ever since 1900, but with especial vigor since the first World War, the long-established hierarchy of manufacturer, jobber or broker, wholesaler, and retailer, has been yielding ground before chain stores, department stores, mail-order houses, and in very recent years supermarkets. While in some cases

[43] This is the essence of the defense of the system made by J. M. Clark and others in National Recovery Administration, *Report on the Operation of the Basing Point System in the Iron and Steel Industry,* 1934. Representatives of the steel and cement trade associations frequently assert that the system intensifies competition by increasing the number of competitors for any market, but such "competition" is of course non-price competition only.

[44] To some extent, this argument presupposes price agreements which may be illegal under the Sherman Act as applied to loose associations. See below, pp. 533–557.

the gain may be ascribed to superior location or service, for the most part the large-scale distributors have won customers by virtue of prices lower than those of their "independent" competitors. And while a portion of the price differential is made possible by larger turnover with lower margins, superior efficiency of sales organization, lower wages to store employees, and elimination of credit risks, delivery costs, and return privileges, a very considerable fraction comes from advantages over independents in the stores' own purchasing prices. For chains, this fraction varies from 8 to as high as 45 per cent.[45]

The extent of such buying advantages is a function of manufacturers' sales policies. The latter generally adhere to one of three methods: (1) a uniform unit price, (2) a base price per unit sold, with graded discounts for quantity purchases, or (3) a series of graded trade discounts from a base price in accordance with a functional customer classification. If the third method is adopted, there are usually at least three customer categories (wholesaler, retailer, and consumer), but the subdivision may be elaborated almost indefinitely. Moreover, when a distributor consolidates several of the traditional functions, as is commonly the case with the newer forms of mass distribution, his buying advantage will depend upon the particular class in which he is placed by the manufacturer.

In the struggle for survival, representatives of the older hierarchy have sought to induce manufacturers both to establish discounts on the basis of functional classification and to classify their customers on the basis of the customers' customers. Chain stores and mail-order houses would thus be given the status and small discount of retailers. The mass distributors, on the other hand, have pressed either for a system of quantity discounts or for classification as wholesalers. In addition, backed by the bargaining leverage of enormous purchasing power,[46] they have demanded and received additional concessions in the form of advertising allowances and extra discounts in lieu of brokerage charges. Manufacturers have sometimes faced the awkward dilemma of making concessions to mass distributors at the risk of boycott by the organized independents, or of making concessions to the latter at the risk of with-

[45] FTC, *Final Report on the Chain Store Investigation,* 1934, S. Doc. 4, 74th Cong., 1st Sess., pp. 53ff.

[46] This is a self-evident consideration in an instance like the Great Atlantic & Pacific Tea Company, which at its peak operated over 15,700 grocery stores.

drawal of patronage, or even competitive manufacturing, on the part of chains.

While a uniform unit-price policy is economically discriminatory if selling costs vary among different customers, discrimination in a legal sense has always presupposed some price *difference*. Quantity or trade discounts precisely proportioned to differences in costs of manufacture or sale for the differing quantities or types of customer are clearly not discriminatory in either an economic or a legal sense. Where such discounts have no basis in cost savings, however, economic discrimination exists which may also, under certain conditions, fall within the ban of Section two of the Clayton Act.

Early in its career, the Federal Trade Commission entered this field in a series of cases. In one it forbade a manufacturer to refuse the wholesale discount to a co-operative buying organization of retailers which purchased in quantities as large as wholesalers. In another, it condemned a manufacturer who granted discounts to chains on the basis of the combined purchases of their separate stores while refusing to grant a similar privilege to associations of independents, even though selling costs did not vary between the two. The Commission was reversed in both instances by a circuit court of appeals, on the ground that the Clayton Act applied only to reduced competition in the *seller's* line of commerce, whereas here any lessening of competition or monopolistic tendency was limited to the distributors.[47] The Supreme Court refused to review these decisions, and the Commission was thus forced to abandon its efforts.

In 1929, however, the Supreme Court reached a contrary conclusion in a case between private parties. The opinion held that the words "in any line of commerce" meant what they said, including purchasers as well as sellers.[48] The Commission thereupon renewed its campaign. Early in 1936, after two years of hearings and the assemblage of over 21,000 pages of testimony, it directed the Goodyear Tire and Rubber Company to cease selling tires to Sears, Roebuck & Company, the country's leading mail-order house, at a price dif-

[47] *Mennen Co.* v. *FTC,* 288 Fed. 774 (1923); *National Biscuit Co.* v. *FTC,* 299 Fed. 733 (1924). In the *Mennen* case, the court also insisted that wholesalers and retailers were in all cases to be distinguished by their own customers, and also gave great weight to the proviso in Section two protecting the right of sellers to select their own customers "in bona fide transactions and not in restraint of trade."

[48] *George Van Camp & Sons Co.* v. *American Can Co.,* 278 U.S. 245 (1929).

ferential greater than the savings in costs on Sears, Roebuck orders. The Commission found that a large number of retail tire dealers and small tire manufacturers had been driven out of business as a result of Goodyear-Sears competition. It insisted that, to be effective, Section two must be interpreted to forbid quantity discounts not reasonably related to differences in costs. A number of delicate legal issues were raised by this order,[49] but they were made merely academic by the subsequent passage of the Robinson-Patman Amendment in the same year.

It is clear that this application of Section two is only remotely related to the original purposes of the Clayton Act. Over a considerable period of time, a continued relative increase in the business of mass distributing agencies may possibly lead to a semimonopolistic position in some fields,[50] although competition between different chains, department stores, and supermarkets themselves may be expected to remain keen in population centers of any magnitude. Under present conditions, the struggle is based upon the asserted merits of independent distributors with regard to social and economic considerations quite apart from any likelihood of chain monopoly. Before dealing with the recent legislative manifestations of this struggle, however,[51] it will be well to consider the contribution of the Federal Trade Commission to American trade practice policy under the broad grant of powers of its own statute, which directed it to prevent "unfair methods of competition."

4. The Federal Trade Commission

Congressional leaders in 1914, as has been shown, added the phrase "unfair methods of competition" to the law to replace abortive efforts at seriatim definition of predatory competitive methods. No wholly unambiguous "Congressional intent" as to its meaning can be drawn from the debates. Various interpretations of the words

[49] For example, since Goodyear tires sold through Sears carried Sears's private brand, while tires sold through other channels carried the Goodyear brand, it might be argued that different commodities were involved.

[50] In its report on chain stores, the Federal Trade Commission adopted this viewpoint: "Should the trend of the past twenty years and particularly of the past decade continue for a like period, we shall have a condition in some lines of chain-store merchandising that few will dispute is monopolistic." S. Doc. 4, 74th Cong., 1st Sess., p. 86.

[51] See below, pp. 595–608.

"unfair methods of competition" were offered. They were substituted for "unfair competition" because the latter had taken on a limited meaning at common law, concerned largely with misrepresentation, whereas the new statute was directed primarily against monopoly-producing tactics. The phrase was generally agreed to cover specific practices already condemned in Sherman Act cases. How much further it might extend was left unsettled. Its very vagueness was considered an asset by many of its proponents in Congress, who looked upon the Commission as an administrative agency to build on this foundation a new commercial law—not merely to see that the game of competition was played fairly but also to ensure that the game continued to be played. Thus, the new administrative mechanism was envisaged both as a more effective prosecuting agency than the Department of Justice and at the same time as a participant with the courts in guiding the flexible development of the legislative standard itself. The Commission was also to carry on, presumably on a more independent basis and with more adequate resources, the investigatory activities of the Bureau of Corporations.

Success in accomplishing these purposes depended upon three major factors: (1) Commission personnel and policy, (2) Congressional support, and (3) judicial co-operation in interpreting the law and in limiting the scope of judicial review so as to leave to the Commission substantial discretion in applying and developing the new standard. The history of the FTC has, in fact, been characterized by long periods of weakness in policy, internal dissension, Congressional hostility, and narrow constriction of its legal authority by the courts. Reluctant in its earliest years to formulate explicit policies for its own guidance and that of businessmen, the Commission soon found its energies diverted into World War work. The war years reversed the Wilson administration's emphasis on the small man's "new freedom"; the new watchword was co-operation by all in the single national endeavor.

A second and more ambitious beginning immediately after the war led to successive reversals in the courts and to vigorous Congressional criticism. Presidents Harding and Coolidge were pledged to "normalcy" and were imbued with a policy of co-operation and support for business, especially big business, wholly at variance with Wilson's skeptical suspicion. They filled FTC vacancies with Com-

missioners sharing their own viewpoints. By 1925 these appointees were in the majority. The new guard viewed its functions as friendliness to business and aid in eliminating those competitive practices which businessmen themselves disfavored. Tentative and uncertain gestures were made toward constructing machinery for business "self-regulation." Doubts of judicial approval, conflicts with the Department of Justice, and internal uncertainty as to the meaning and desirability of an altered policy prevented the Commission from making much headway on this newer road. In the early depression years, therefore, it was an almost universally despised body, recognized as a useful investigator for specific purposes and as a mild check upon unethical and fraudulent sales tactics, especially in advertising, but clearly in no sense an effective agency of antitrust law enforcement or trade practice regulation.

Under the Roosevelt regime, FTC personnel has again been altered, the new Commissioners being more in sympathy with the original purposes of the organic act.[52] Between 1933 and 1935, antitrust policy was largely in abeyance because of the National Industrial Recovery Act. Since then a more energetic attitude has been displayed by the FTC. Indications have appeared of a determination to expand the prohibitions of "unfair methods of competition" into a body of vital administrative law. Congress has somewhat broadened the powers and simplified the procedure of the FTC through the Wheeler-Lea Amendment of 1938. The courts, too, recently have displayed less antipathy to the Commission. It is doubtful, however, that FTC regulation of trade practices can become really significant without a more thorough redefinition of antitrust policy by Congress itself. A quarter century's experience with the 1914 statute has left its original purposes almost wholly unaccomplished.

The division of function implicit in its statutory duties is reflected in the Commission's internal organization. Investigations are generally handled by the Economic Division, under a Chief Economist. When possible antitrust law violations or other legal matters are being considered, the economic staff is supplemented by attorneys

[52] It was the effort of President Roosevelt to remove Commissioner William E. Humphrey, the leading "conservative" of the FTC, which led to the Supreme Court decision in *Rathbun (Humphrey's Executor)* v. *United States*, 295 U.S. 602 (1935), limiting the removal power of the President over quasi-judicial and quasi-legislative officers.

from the Chief Examiner's Division. Legal work, which has generally absorbed the greater part of the Commission's funds and personnel,[53] is entrusted to various Divisions under the Chief Counsel.

ECONOMIC INVESTIGATIONS

Through its economic investigations, the FTC has made some substantial contributions to the development of public policy and industrial regulation. Some of its 1914 proponents viewed the Commission as an instrument for regulation through "pitiless publicity," to be engaged in a continuous and relentless exploration of corporate price and output policies and competitive practices. Market imperfections, they hoped, would be reduced by generalized knowledge, and unfair practices would be exposed at the same time. To this end, the FTC was endowed with general authority as follows:

> Section 6 (a) To gather and compile information concerning, and to investigate from time to time the organization, business, conduct, practices, and management of any corporation engaged in [interstate] commerce, excepting banks and common carriers . . . and its relation to other corporations and to individuals, associations, and partnerships.
>
> (b) To require, by general or special orders, corporations . . . to file with the commission in such form as the commission may prescribe annual or special . . . reports or answers in writing to specific questions, furnishing to the commission such information as it may require as to the organization, business, conduct, practices, management, and relation to other corporations, partnerships, and individuals. . . .
>
> (d) Upon the direction of the President or either House of Congress, to investigate and report the facts relating to any alleged violation of the antitrust acts by any corporation.
>
> (f) To make public from time to time such portions of the information obtained by it hereunder, except trade secrets and names of customers, as it shall deem expedient in the public interest; and to make annual and special reports to the Congress and to submit therewith recommendations for additional legislation. . . .
>
> Section 9. That for the purposes of this Act the commission . . . shall at all reasonable times have access to, for the purpose of examination, and the right to copy any, documentary evidence of any corporation being

[53] In the fiscal year 1939–40, $1,401,336 were spent on legal activities, as against $239,557 on general investigations. The latter figure varies from year to year, in accordance with demands of the President and Congress for economic investigations, and generally absorbs several hundred thousand dollars. Of the FTC staff of about 650, over two thirds are employed in connection with legal activities.

investigated or proceeded against; and the commission shall have power to require by subpoena the attendance and testimony of witnesses and the production of all such documentary evidence relating to any matter under investigation. . . .

In practice, however, it has been impossible to use continuous publicity under FTC guidance as a regular means of trade practice control. The obstacle has been threefold: in the courts, in Congress, and in the Commission itself. At the very start, the Commission undertook to expand and systematize the work of the Bureau of Corporations by gathering periodical statistical information on market conditions and business organization over the whole field of industry on a voluntary basis. It met with little success. In the first World War and immediate postwar years a further attempt in this direction was begun. This effort was restricted to foodstuffs, other necessaries of life, and basic industries, and was backed by the compulsory powers of Section nine. This time it was delayed by court proceedings. FTC appropriations for this purpose soon expired and the new Congress was not favorably inclined toward the Commission. In place of the Wilsonian plea for "pitiless publicity," Congressman Wood of the House Appropriations Committee expressed his opinion that "there is too much of sticking your nose into other people's business." [54] Nor did the Commission itself, after the political transformation of 1925 which placed the Wilsonians in a minority, press for widespread initiative in economic investigations. Only at the end of 1939 was general industry reporting reinstituted, "with a view to developing and publishing the significant facts regarding the general trend of, or changes in, the economic situation." [55]

In his message on the antitrust laws in April, 1938, President Roosevelt recommended creation of a "Bureau of Industrial Economics," with power to supplement the industrial statistics of trade associations. It would disseminate market information and issue warnings against "the dangers of temporary overproduction and excessive inventories as well as against the dangers of shortages and bottleneck conditions and encourage the maintenance of orderly markets." The New Deal FTC, more like its Wilsonian grandfather

[54] Appropriations Committee Subcommittee, 68th Cong., 2nd Sess., *Hearings* on Independent Offices Appropriations Bill for 1926 (1925), p. 117.

[55] FTC, *Annual Report*, 1940, p. 18.

than its immediate predecessor of 1925 to 1933, has suggested its willingness to perform this function, given sufficient appropriations, by the use of its existing powers. The Commission even envisaged the possibility of supplanting the statistical services of private trade associations in order to "avoid the temptations of illegal co-operation." [56] Although the arguments in favor of establishing some such service in the hands of a public agency are strong, there is no immediate prospect of large-scale action along this line.

Despite the apparently all-embracing provisions of the statute, various court decisions have seriously confined the FTC's powers to require the submission of economic information. The limitations are based in part on a strained interpretation of the words of the statutory grant, but in part also on the constitutional restrictions of the Fourth (searches and seizures) and Fifth (due process) Amendments and the commerce clause. In 1923 a federal court, by a two to one majority, forbade the FTC to demand data on costs and other matters from iron and steel companies, on the grounds (1) that their manufacturing activities were intrastate and (2) that the FTC Act in any case limited investigations to alleged violations of Section five and of the antitrust laws.[57] Since this decision was reversed by the Supreme Court for technical reasons wholly independent of the major point at issue, the Commission still lacks a final legal determination of its general investigatory powers. It is probable, however, that the amplified interpretation of the commerce clause since 1937 would lead to a reversal of the lower court's first objection, while the second is directly contrary to the statute's unambiguous terminology.

The only Supreme Court decision in this field was handed down in 1924. An investigation of the tobacco industry, pursuant to a Senate resolution, had been followed by a formal FTC complaint under Section five. The Commission sought to examine all correspondence between the leading tobacco companies and their jobber customers. The reviewing courts forbade it to do so, holding that the Senate resolution conferred no authority, since it was not based on an alleged violation of the antitrust laws in accordance with Section 6(d). A construction of the statute permitting the Commission's request to be granted, it was held, might place it within the ban of the Fourth Amendment.

[56] FTC, *Annual Report*, 1938, p. 12.
[57] *FTC* v. *Claire Furnace Co.*, 285 Fed. 936 (1923).

> Anyone who respects the spirit as well as the letter of the Fourth Amendment [said Justice Holmes] would be loath to believe that Congress intended to authorize one of its subordinate agencies to sweep all our traditions into the fire . . . and to direct fishing expeditions into private papers on the possibility that they may disclose evidence of crime. We do not discuss the question whether it could do so if it tried, as nothing short of the most explicit language would induce us to attribute to Congress that intent. The interruption of business, the possible revelation of trade secrets, and the expense that compliance with the commission's wholesale demand would cause are the least considerations. It is contrary to the first principles of justice to allow a search through all the respondents' records, relevant or irrelevant, in the hope that something will turn up. . . . The question is a different one where the State granting the charter gives its commission power to inspect.[58]

Subsequent lower court decisions disagree as to whether the compulsory testimony provisions of Section nine apply at all to general investigations. The most authoritative holding supports the FTC's right to compel witnesses to attend and to answer pertinent questions, subject to the constitutional immunity against self-incrimination, but denies a general power to compel the submission of books and papers.[59] In the absence of Supreme Court rulings on these latter questions, it remains uncertain how much compulsory power resides with the Commission under the present law. Nor is it yet clear how far Congress might widen this power without violating the Fourth Amendment. It is, of course, a well-settled doctrine that the latter, although in terms a "right of the people," protects corporations as well as natural persons. The above-quoted words of Justice Holmes suggest that continuous investigation and publicity as a regulatory device may be constitutionally permissible only on the basis of federal incorporation or licensing of all corporations engaged in or affecting interstate commerce.[60]

[58] *FTC* v. *American Tobacco Co.,* 264 U.S. 298, 305–306.

[59] Cf. *FTC* v. *Smith,* 34 F. (2d) 323 (1929), disagreeing with *Millers' National Federation* v. *FTC* (not reported, Sup. Ct. D.C., 1926).

[60] In 1936 a bill was introduced in the Senate expanding Sections six and nine to the constitutional limit by allowing general investigations on the initiative of the President or either House of Congress, as well as the Commission itself, and also by delegating to the FTC the general Congressional authority to obtain information in aid of legislation. The latter clause was deleted in Senate Committee, but the former passed the Senate in both 1936 and 1937. Strenuous opposition to increased investigatory power for the FTC was expressed by the United States Chamber of Commerce, the American Newspaper Publishers' Association, the National Association of Man-

Despite this atrophy of its general investigatory power, partly through voluntary disuse and partly through outside limitation, FTC investigations have frequently contributed in an important manner to public policy. More than one hundred studies have been conducted, ranging over the entire industrial and commercial scene. The reports vary in comprehensiveness from the eleven pages devoted to Southern Livestock Prices in 1920 to the ninety-five volume survey of Gas and Electric Utility Corporations in 1928–35. For the most part, the initiative for these undertakings has come from Congressional resolutions, which often carry special appropriations. Only a few investigations were begun on request from the President, the Attorney General, or the Commission itself. Thus, the significance of this branch of FTC activity depends largely on the mood of Congress. On occasions the Congressional motive has been a desire to conciliate important electoral groups without any serious intent to modify legislative policy. In 1924, the conservatively inclined House Appropriations Committee, feeling that many resolutions of the more radical Senate were thus "politically" inspired, added to the Appropriation Act a rider forbidding the use of FTC funds for investigations except when approved by concurrent resolution of both Houses, unless such investigation involved antitrust law violations. Even the latter exception was removed in 1933, in the desire to promote economy by reducing the number of investigations.

Positive results have varied with the immediate political situation and the thoroughness of the particular investigation, as conditioned by Congressional limitations on funds and judicial limitations on compelling testimony. At times, the revelation of unethical or illegal activities in the course of an FTC inquiry has led directly to discontinuance by the private interests concerned, without recourse to administrative action. Thus, the postwar tobacco investigations resulted in voluntary abandonment of price-fixing agreements among jobbers. The extraordinary propaganda activities of the National Electric Light Association and other groups—a campaign conducted in schools, colleges, clubs, the press, and elsewhere to cultivate good will, discredit public ownership, and discourage effective

ufacturers, the National Retail Dry Goods Association, the Associated Grocery Manufacturers of America, and other business interests. As a result, the House Committee on Interstate and Foreign Commerce removed all reference to Section six, which remained untouched when the Wheeler-Lea Act of 1938 was finally passed.

regulation of the electrical utility industry—were revealed in 1928 and 1929; the effectiveness of these activities was substantially curtailed and the Association was dissolved.[61] Other investigations have led directly to administrative action, by the Department of Justice or the Commission itself. Cases in point are antitrust suits against the meat packers in 1920, the International Harvester Company in 1923, and various lumber trade associations from 1920 to 1923. Formal FTC prosecutions were instituted as a result of general investigations in the *Gasoline Pump* cases (1920) and the *Cement Institute* case (1937), among others.[62] The Steel Code under the National Industrial Recovery Act was modified in consequence of an FTC report on the effects of the basing-point system under Code protection. The Commission's investigations of the oil industry led in 1924 to the appointment of the Federal Oil Conservation Board.

Perhaps the most striking and valuable contributions of the FTC to policy formation may be seen in its collection of data as the groundwork for new legislative departures. The Packers and Stockyards Act of 1921, which gave to the Department of Agriculture general supervisory powers over the meat-packing industry and close control, on the public utility model, over stockyards and market agencies, was a direct consequence of the controversial FTC reports of 1918 and 1919. The Grain Futures Administration (now the Commodity Exchange Administration) was likewise set up in the Department of Agriculture after an FTC investigation. In 1935, Congress utilized the elaborate Utility Corporation study as the foundation for the Wheeler-Rayburn Act, which controls the interstate transmission of electric power and limits the use of holding companies in this field. The Robinson-Patman Act of 1936, finally, grew, in part, out of the Chain Store Investigation of 1931–34.

These positive results, in addition to the potentially useful comprehension of the workings of our economic structure, are no mean return on an expenditure of a few hundred thousand dollars a year. They are far removed, however, from the aspirations of the founders of the FTC. The existence of such an agency, with a corps of trained investigators, has been an important public asset.

[61] See above, pp. 308–310.

[62] The failure of a number of these actions in the courts does not, of course, discredit the usefulness of FTC investigations in supplying a factual basis for subsequent administrative action.

But the powers of fact finding and publicity have failed to serve as an integral part of the regulatory process itself, in the manner in which they were intended. The experience of the Commission with its administrative and quasi-judicial functions has been similarly far removed from the original purposes.

UNFAIR METHODS OF COMPETITION

The phrasing of Section five of the FTC Act left uncertain not only the extent of the grant of substantive powers, but also the division of function between the Commission and the courts. The Interstate Commerce Commission was frequently cited as a model; since 1906 it had been freed from the confines of all-inclusive "broad" judicial review and left to blaze new trails of administrative law. The new Commission made no attempt to define conclusively the standard of "unfair methods of competition" by an all-embracing listing. In its first public statement on the subject, in 1916, the FTC recognized that its creation was a feature of antitrust policy, that its administrative authority was meant to supplement the Sherman Act, and that "unfair methods" meant primarily methods lessening competition, restraining trade, or tending toward monopoly. The common-law doctrine of "unfair competition" led the Commission to assume that false and misleading advertising might also fall within its jurisdiction. It reviewed the common-law background and the previous interpretation of the Sherman Act, making note of the specific practices described at the opening of this chapter. But it also envisaged future expansion of the standard as the need might arise.

The Commission's first court case arose from an order directing Sears, Roebuck & Company to cease misrepresenting its low sales price for sugar as a consequence of mass purchasing power and large turnover, when the company was, in fact, taking heavy losses on the sales and using sugar as a "loss-leader." The order also sought to forbid the sales themselves at a price below cost. While the reviewing court refused to sanction the latter prohibition, holding that only the misrepresentation itself might be outlawed, the opinion favored a broad interpretation of FTC power. It emphasized the right of respondents to their day in court and the function of judicial review in keeping the Commission within bounds. Subject to those limitations, however, it said:

The commissioners, representing the Government as *parens patriae,* are to exercise their common sense, as informed by their knowledge of the general idea of unfair trade at common law, and stop all those trade practices that have a capacity or a tendency to injure competitors directly or through deception of purchasers, quite irrespective of whether the specific practices in question have yet been denounced in common-law cases.[63]

Taking heart from this decision, the Commission announced in 1919 that it felt itself "empowered to leave the shores defined by the common law and, taking the knowledge of these [common-law] decisions with it, to embark on an uncharted sea, using common sense and the common law for its compass." [64] The Commission did not foresee that the judicial restraints would be so far reaching as to push it back, with few exceptions, from its "uncharted seas" to the well-known coastal waters of pre-existing common-law and anti-trust-law interpretation.

The administrative procedure of the FTC is quite complex. Almost all cases of allegedly unfair competitive methods are brought to its attention by informal complaints from competing businessmen, consumers, or other directly affected interests. Practices disclosed in the course of general investigations also sometimes lead the Commission to set its machinery in motion. Many informal complaints are frivolous on their face, deal with matters clearly beyond the law, or are concerned purely with intrastate commerce and are hence outside FTC jurisdiction. Moreover, the Commission is to act only when a proceeding would be "to the interest of the public." Both by Commission rulings and by judicial interpretation, purely private controversies redressable in the courts must not be handled unless the "public" is substantially involved.[65]

If these jurisdictional requirements are satisfied, preliminary inquiry follows, involving correspondence with the alleged malefactor. An "application for complaint" is then docketed and the facts investigated by a Commission attorney, who recommends further action to the Chief Examiner or (since 1938) to the Special Radio and Periodical Division. These officers may recommend that

[63] *Sears, Roebuck & Co.* v. *FTC,* 258 Fed. 307, 311 (1919).

[64] FTC, *Annual Report,* 1919, p. 45.

[65] The decision on this issue is made, of course, by the FTC staff in the first instance, but it is noteworthy that the Commission has been reversed in the courts on several occasions on the ground that public interest was not involved. See especially *FTC* v. *Klesner,* 280 U.S. 19 (1929).

the Commission close the case or issue a formal complaint. Since 1925, it has also been possible for respondents, at the FTC's discretion, to sign a "stipulation" as to the facts and agree to cease and desist from the charged practices, thereby avoiding further action.[66] Only at this point does formal action under the statute, together with publicity, begin. Of over 14,000 cases from 1915 to 1940, in which applications had been docketed and final disposition made, 41 per cent were dismissed, 33 per cent settled by stipulation, and only 26 per cent led to formal complaints.

The decision to issue a formal complaint is made by the Commissioners themselves. The statute requires adequate notice and hearing, and permits interested parties to intervene. In one case out of four the respondent does not contest the complaint, and a "cease and desist" order follows as a matter of course. Otherwise a formal public hearing is held before a trial examiner, respondents being represented by counsel and the Commission by an attorney delegated by the Chief Counsel. The examiner reports to the full Commission, which also receives briefs from both sides. Final argument takes place before the five Commissioners sitting in a quasi-judicial capacity. They must either dismiss the complaint or issue their ultimate findings of fact together with a formal order to cease and desist from specified practices. Over three fifths of the contested complaints are, in fact, dismissed.

Before 1938, violation of an FTC order entailed no automatic penalty. The Commission first had to apply to a federal circuit court of appeals for enforcement of its order, and to justify it in a judicial proceeding. The validity of an order might also (as it still may) be tested in court by a petition for judicial review on the part of the respondent. Some courts refused to issue a decree of enforcement without proof by the Commission that the order had been violated, even though the order itself might be valid. Thus, the procedure of enforcement was exceedingly slow and cumbersome. Under the Wheeler-Lea Amendment of 1938, the Commission is greatly aided, for unless a respondent petitions for review within sixty days the order automatically becomes final and each violation subject to a civil penalty of up to $5,000.

The new procedure guarantees to a respondent the right to his

[66] From 1925 to 1933 the names of respondents entering into such stipulations were not made public.

"day in court," if he chooses to demand review. The old procedure ensured judicial review in any case before a formal penalty could be imposed, although mere publication of a cease and desist order must itself be viewed as a penalty of some consequence. Under these circumstances it lies within the courts' judgment to give as little or as much weight to FTC discretion as they please. Their only statutory guide is the provision that "the findings of the commission as to the facts, if supported by testimony, shall be conclusive." Questions of law are subject to final determination by the courts themselves.

In practice, however, there is no determinate, hard and fast line between matters of fact and matters of law. On questions of law furthermore, and especially on the all-important issue of the meaning to be given to "unfair methods of competition," the reviewing courts could act within a wide discretionary zone. On the one hand, they might respect the judgment of the expert, quasi-judicial Commission, restraining it from overzealous attacks on legitimate private interests, but permitting it to guide the growth of a vital administrative law in harmony with the purposes of antitrust policy. On the other hand, they might confine the standard of the law to the minimum, weigh the evidence on the facts for themselves, and reduce the Commission to the role of public prosecutor in a special field. From 1920 to 1933, the latter alternative was adopted. Since that time, the Commission has had somewhat more leeway, but not yet enough to compensate for earlier reversals. The constraining attitude of the judiciary has played a leading part in reducing FTC effectiveness. But it must also be noted that from 1925 on the Commission itself took few steps to improve its own situation.

The first and most decisive blow from the judiciary fell in 1920, in the initial Supreme Court decision under the FTC Act. The Commission had ordered a subsidiary of Carnegie Steel to cease selling steel ties for cotton bagging on the condition that buyers also take a proportionate amount of bagging. Reversal of the Commission was based on a technical issue of procedure, namely, that the formal complaint had failed to allege in specific terms injury to the public or to competitors. Speaking through Justice McReynolds, the Court took the opportunity to announce its conception of the statute in these terms:

> The words "unfair methods of competition" are not defined by the statute and their exact meaning is in dispute. It is for the courts, not the commission, ultimately to determine as matter of law what they include. They are clearly inapplicable to practices never heretofore regarded as opposed to good morals because characterized by deception, bad faith, fraud, or oppression, or as against public policy because of their dangerous tendency unduly to hinder competition or create monopoly. The act was certainly not intended to fetter free and fair competition as commonly understood and practiced by honorable opponents in trade.[67]

Justice Brandeis expressed his dissent in a forceful opinion, concisely summarizing the background of the legislation in which he himself had played an important part. In his judgment, the standard had purposely been left flexible and the Commission established for the very purpose of guiding its development. Judicial review would be confined to the question of "whether the particular practice could, under any circumstances, reasonably be deemed an unfair method of competition." An examination of the record convincingly demonstrates that Brandeis was closer to the original intent than the majority, but he carried only one other justice with him.

Taken literally, the Supreme Court's words "never heretofore regarded" would have limited the FTC to administration of preexisting legal rules. They would have added nothing to the common law and the Sherman Act but a new agency and procedure of enforcement. They were, in fact, largely applied by the lower courts in this discouraging manner, and with few exceptions were followed by the Supreme Court itself. In consequence, the FTC abandoned serious effort to strike out into new spheres where legal trade practice regulation was inadequate. It concentrated instead upon those few areas where it was able to persuade the courts to open the gates. Through the limitations set by judicial review, the Commission's principal attention was deflected away from preserving competition by attacking competition-destroying practices and into maintaining a minimum plane of honesty and fair dealing for such competition as might persist.

Such headway as the FTC has made in outlawing restraints of trade and incipient monopoly goes little further than the Sherman Act. Just as the intercorporate stockholding provisions of the Clayton Act were emasculated in the course of judicial review, so also

[67] *FTC* v. *Gratz*, 253 U.S. 421 (1920).

has the Commission been frustrated in its attempts to extend the law to newer types of restraints. The gasoline-pump cases and the attack on motion-picture block booking, already described, are instances in point. The FTC has met with outstanding success only in its prosecutions of resale price maintenance and of concerted efforts by associations of manufacturers, wholesalers, or other dealers to restrict the channels of trade. In these fields the substantive addition to the law of the Sherman Act has been almost negligible.

The very success of the Commission in attacking resale price maintenance led eventually to legislation designed to encourage the practice. Whereas cases under the Sherman Act had only outlawed explicit agreements to maintain prices, the FTC was able to persuade the Supreme Court to adopt the realistic attitude that systematic black-listing of price cutters and elaborate enforcement machinery set up by a manufacturer were equivalent to an implied agreement.[68] On the other hand, the courts also attempted to uphold the contradictory doctrine that a seller could refuse to do business with any purchaser for any reason. Inherently irreconcilable with the principle that price maintenance is unfair because of its economic results, this doctrine led on occasion to partial or complete reversal of FTC orders.[69] The law was thus left in a profoundly unsatisfactory condition. The administrative tribunal was not permitted to base its rulings on the crucial consideration of effects of the practice on the channels of trade; at the same time businessmen favoring resale price maintenance were sufficiently hampered to be annoyed, and yet never forced to abandon all varieties of price-maintaining tactics. The practice was legalized in many fields through NRA codes, and subsequently sanctioned over the greater part of the country through state "Fair Trade" Acts and the Miller-Tydings Amendment of 1937 to the Sherman Act.[70]

As far as co-operative activities on the part of loose associations are concerned, the FTC has added nothing to the law under the Sherman Act. The latter, however, has generally been more strictly construed against such associations than against close consolidations. Until recent years better financed and staffed than the Department of Justice's Antitrust Division, the FTC has accomplished results of some consequence in this area through prosecutions on a wide

[68] *FTC* v. *Beech-Nut Packing Co.*, 257 U.S. 441 (1922).

[69] See, for example, *Cream of Wheat Co.* v. *FTC*, 14 F.(2d) 40 (1926).

[70] See below, pp. 603–606.

front. Its reports contain orders against agreements on prices, terms of sale, and market territories, against associations boycotting competitors, against organized boycotts designed to limit business to "legitimate" dealers of the traditional distributive hierarchy, and against trade association activities tending toward establishment of artificial price uniformity. This is a measurable, if modest, contribution to the enforcement of antitrust policy. It is noteworthy, however, that the FTC has had almost no success whatever in restraining single, dominating corporate enterprises or "trusts," the doings of which were so largely responsible for its formation.

FALSE ADVERTISING AND MISBRANDING

The more fruitful branches of FTC legal activity have sprung from the second element of its ancestry, the common-law doctrine of "unfair competition." The Supreme Court's dictum in the *Gratz* case, which seemed to bring within the Commission's jurisdiction practices "heretofore regarded as opposed to good morals because characterized by deception, bad faith, fraud or oppression," clearly had reference to pre-existing, judge-made law. With this phrase as its guide, the FTC has been able to supplement private common-law defenses against unethical practices such as systematic disparagement of competitors, commercial bribery, espionage, and passing-off. By a striking Supreme Court victory in 1922, moreover, it was enabled to enter the analogous and infinitely broader field of false advertising and misbranding, a field which has ever since occupied the lion's share of its attention.

The 1922 case, *FTC* v. *Winsted Hoisery Company,*[71] arose out of the common practice in the wool trade of labeling clothing knitted of mixed materials as "Natural Wool," "Australian Wool," etc. A lower court reversed the Commission's order against this type of misbranding, on the ground that other manufacturers understood the labels and that deception of consumers was irrelevant, since the method was not unfair as against *competitors*. The Supreme Court, on the contrary, stressed the deception of the consuming public. The opinion declared that competitors marking their goods truthfully were "necessarily" affected and that the practice was consequently an unfair method of competition.

For nine years, the FTC viewed this decision as "the Magna Carta of truth in interstate trade and of incalculable service to both

[71] 258 U.S. 483.

industry and the public at large." [72] Hundreds of orders and stipulations dealing with such deceptive tactics were entered during this period. A Special Board of Investigation (reorganized in 1938 as the Radio and Periodical Division) was set up in 1929 to handle the flood of informal complaints in this field, and thousands of practices were modified through informal negotiation. They included misstatements not only of ingredients, but also of quality, origin, and purity of commodities, misleading trade names or slogans suggesting that a dealer saved costs by selling "direct from manufacturer to consumer," false representations of government endorsement, and many other deceptive concomitants of hectic, nonprice competition. There were several setbacks in the courts, but the cases turned largely upon the issue of whether there was, in fact, substantial deception of the public, or whether exaggerated advertising could be construed merely as legitimate "puffing." A crusade against false advertising and misbranding, conducted frankly in the interest of consumers and the more ethical competitors in any field, thus became the FTC's chief pursuit. However distant from the basic purposes of the Commission, the desirability of this activity could hardly be impugned.

In 1931, however, the FTC received a sharp reversal at the hands of the Supreme Court.[73] At the instigation of the American Medical Association, the Commission had forbidden the Raladam Company to represent "Marmola," a product consisting partially of thyroid extract, as a "scientific remedy for obesity," and from advertising it without stating that it might be safely administered only under medical advice. The Court admitted that the order was designed to protect the public against a dangerously misleading advertisement. The reversal was based upon a restatement of the jurisdictional requirements under Section five. That section was now held to demand not only that a practice be unfair, and that its suppression be in the public interest, but also that it be a method of *competition,* and that the Commission establish substantial evidence of injury to competitors. In this instance the FTC had not proven injury to other patent remedy manufacturers. The suggestion that doctors might suffer was rejected on the ground that they were engaged in

[72] R. S. Ely, "The Work of the Federal Trade Commission," 7 *Wisconsin Law Rev.,* 195, 209–210 (June, 1932). The author of this article was then an attorney on the Commission's staff.

[73] *FTC* v. *Raladam Co.,* 283 U.S. 643.

a profession, not a trade, and that they did not manufacture or sell remedies, but only prescribed them. The decision led to the paradoxical conclusion that a monopolistic seller, or one in a trade with no honest competitors, could misbrand his product to his heart's content, while the public would be protected against fraud only in a trade where unethical competitors had ethical rivals. Aside from this difficulty, the FTC was greatly hampered by having to prove specific injury to competitors in each case.

From 1935 on, the Commission recommended annually that it be relieved of this burden through statutory amendment. Its request was finally granted in the Wheeler-Lea Act of 1938, which amended Section five to forbid "unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce." While under consideration, the measure was opposed by representatives of the larger business organizations, and especially by magazine and newspaper publishers, who feared a disturbing effect on advertising revenue. Associations of smaller businessmen, on the other hand, especially independent retailers, went on record in its support. The new Act also gave the Commission special powers to control the false advertising of foods, drugs, cosmetics, and therapeutic devices, paralleling the new powers of the Food and Drug Administration (then in the Department of Agriculture, but subsequently transferred to the Federal Security Agency) against misbranding and adulteration.[74] Apart from the new legislation, the FTC has additional reason to be encouraged in a far more favorable judicial attitude toward its decisions during the last few years. The alteration affects both the scope of judicial review and the definition of the Commission's powers. Until 1934, the lower federal courts had tended to an increasing extent to substitute their own judgments on the facts for those of the Commission. In that year, out of a blue sky, the Supreme Court administered a stinging rebuke to this practice, chastising a circuit court for honoring the statutory division of function "with lip service only." [75] And a subsequent Supreme Court opinion declared that "the courts cannot pick and choose bits of evidence to make findings of fact contrary to the findings of the Commission." [76]

[74] Cf. above, pp. 206–207.
[75] *FTC* v. *Algoma Lumber Co.*, 291 U.S. 67 (1934).
[76] *FTC* v. *Standard Education Society*, 302 U.S. 112 (1937).

Even more important was a second decision in 1934, which, if consistently followed, will go a long way toward counteracting the hampering effects of the *Gratz* case. A series of orders had been issued by the FTC against the widespread practice among candy manufacturers of selling their goods to children by means of lottery devices. Many competitors, on moral grounds, refused to follow suit, and were substantially injured. The lower court refused to sustain the Commission, holding that consumers were not deceived, that competitors could maintain their position by adopting the practice themselves, and that no monopolistic tendency had been demonstrated. This view was unanimously rejected on appeal to the Supreme Court. That tribunal stressed the proven injury to competitors in this instance and the long-established policy of many states against lotteries. But its words also opened to the Commission a road toward expansion of the law of unfair competitive methods which had seemingly long been closed:

> But we cannot say that the Commission's jurisdiction extends only to those types of practices which happen to have been litigated before this court. Neither the language nor the history of the act suggests that Congress intended to confine the forbidden methods to fixed and unyielding categories. . . . The act undoubtedly was aimed at all the familiar methods of law violation which prosecutions under the Sherman Act had disclosed. . . . But as this court has pointed out it also had a broader purpose. . . . It is true that the statute does not authorize regulation which has no purpose other than that of relieving merchants from troublesome competition or of censoring the morals of businessmen. But here the competitive method is shown to exploit consumers, children, who are unable to protect themselves. . . .
>
> While this court has declared that it is for the courts to determine what practices or methods of competition are to be deemed unfair . . . in passing on that question the determination of the Commission is of weight. It was created with the avowed purpose of lodging the administrative functions committed to it in "a body specially competent to deal with them by reason of information, experience, and careful study of the business and economic conditions of the industry affected," and it was organized in such a manner, with respect to the length and expiration of the terms of office of its members, as would "give to them an opportunity to acquire the expertness in dealing with these special questions concerning industry that comes from experience. . . ." If the point were more doubtful than we think it, we should hesitate to reject the conclu-

sion of the Commission, based as it is upon clear, specific, and comprehensive findings supported by evidence.[77]

In this reversal of judicial attitude, the improved form of the Commission's published findings of facts undoubtedly played some part. So also did the generally lessened respect of the courts for the tenets of laissez-faire philosophy. The consequences in the court record of the FTC are striking. Whereas from its inception until 1933 the Commission won sixty-nine cases and lost sixty-three, in the following seven years it lost only eleven while winning one hundred. It is not to be supposed that FTC action will now produce everything expected of it in 1914, but the Commission has clearly been placed in the strongest position in its career.

THE TRADE PRACTICE CONFERENCE

Reference has already been made to the three broad eras into which the work of the FTC may be divided. Such success as the Commission has had with its formal powers was largely the work of the Wilson and Roosevelt appointees. Emphasis on co-operation with business characterized the policy in all fields after the appointment of Commissioner W. E. Humphrey in 1925. The rules were changed, by three to two vote, to permit settlement of cases by stipulation, to withhold names of respondents from publicity in cases thus settled, and to cease releasing public statements when complaints were issued. These alterations were all designed to remove procedural features which had made the Commission up to that time anathema to big business. By far the most important contribution of the Coolidge Commission, however, was its elaboration of an informal method of eliminating objectionable trade practices through conferences with representatives of entire industries.

Shortly after the first World War, the Commission had discovered that in certain industries fraudulent, deceptive, or oppressive practices were so widespread as to be almost universal. In a highly competitive area, misrepresentations as to quality, commercial bribery, and similar tactics, once begun by an unethical few, spread perforce to the many, however desirous they might be to resist them. The FTC therefore invited representatives of all the firms concerned to meet informally with one of the Commissioners, and to submit proposed minimum standards together with lists of prac-

[77] *FTC* v. *R. F. Keppel & Bros.*, 291 U.S. 304, 309–314 (1934).

tices considered unfair by the trade. After submission of the proposed rules to the entire industry, the Commission declared its intention to use them as "prima facie law merchant," [78] a guide to subsequent formal action. The procedure could evidently not make illegal any practice not construed by the courts as within the Clayton or Trade Commission Acts.[79] These "Trade Practice Submittals," as they came to be called, were wholly extralegal. Yet they might evidently be a valuable guide to the FTC in its choice of prosecutions. Co-operation of the Commission, moreover, promised sanctions against violation which made compliance far more likely than with trade association standards set up in the absence of official authority.

From 1919 to 1925 a few Submittals were entertained each year. As the court decisions in FTC cases multiplied, the Commission became increasingly aware of the limited flexibility of its statute; it therefore began to classify proposed rules into two groups. Group I rules were positively approved. Practices there set forth were construed as legally unfair competitive methods, and the Commission undertook to prosecute violations. Group II rules were merely expressions of industry opinion recognized by the Commission as sound and deserving of general compliance; violation of such rules, however, was not illegal and could not be prosecuted. More recently, the Commission has on occasion distinguished a third group of rules, namely, industry proposals affirmatively rejected as contrary to the antitrust laws. A fourth group consists of proposals to be held in abeyance for further consideration before classification.

When Humphrey's accession placed the Coolidge appointees in a majority, the Commission set about elaborating the Trade Practice Submittal procedure as a means of positive co-operation with business. It promoted the Submittals as a form of "self-government for industry." The new name of "Trade Practice Conference" was adopted. A special Division of Trade Practice Conferences was set up in the Commission's administrative structure in 1926. Steps were taken to familiarize the business world with the new avenue for

[78] An expression used by Commissioner Colver at a conference in 1919. FTC, *Trade Practice Conferences* (1929), p. 2.

[79] This was strikingly shown in the judicial reversal of the Commission in a series of cases prosecuting manufacturers who refused to accept a rule on the labeling and advertising of veneered furniture. *Berkey and Gay Furniture Co.* v. *FTC*, 42 F.(2d) 427 (1930).

co-operative activity. The number of conferences rose from five in 1926–27 to fifty-seven in 1929–30. The scope of the rules was greatly widened. Group I was still held for the most part within the limits of established law, although a common provision, of doubtful legality, forbade sales below cost "for the purpose of injuring a competitor and with the effect of lessening competition." Antiprice discrimination provisions were also generally more far reaching than the terms of the Clayton Act. Group II, however, tended to leave the safe and unquestioned domain of quality standards, product standardization, prohibitions of design piracy, arbitration techniques, and other such matters, and to include to an increasing extent uniform terms of sale, agreements to observe basing-point systems, costing systems designed to engender price uniformity, and prohibitions on dealing through "nonlegitimate" trade channels. In short, from an instrument for preservation of fair methods of competition, the FTC was being converted into a device for eliminating price competition itself. There is reason to suppose that many trade associations promoted Trade Practice Conferences in the mistaken belief that FTC "acceptance" made legal what was otherwise forbidden by the antitrust laws.

The Department of Justice became suspicious of certain Conference rules in 1930. The Commission, informed of these doubts, suddenly announced wholesale revisions of the rules in order to confine them once more within the bounds of judicially declared legal norms. Affected industries were angered by the alterations, particularly since they had been made without prior notice. A "Congress of Industries" was organized as a forum for protests, and the Commission was induced to modify its alterations to a considerable extent. Nevertheless, business confidence in the Trade Practice Conference was badly shaken. The number of conferences fell to about ten a year. Failure of this procedure to satisfy the demands of trade associations for industrial "self-regulation" was a powerful stimulus in the rapidly growing movement of the late twenties for modification of the antitrust laws. When this objective was temporarily won under the National Industrial Recovery Act, Trade Practice Conference experience was heavily drawn on in the formulation of the new "codes of fair competition."

Since the demise of the NRA in 1935 the Commission has resumed the use of Trade Practice Conferences over a wide field, but with more modest expectations than in the middle twenties. The

Conferences are now looked upon as opportunities for "clarification and codification of legal requirements and the organization of co-operative endeavor under supervision of the Commission in the elimination of undesirable practices and the maintenance of fair competitive conditions." [80] With the recently developed trend on the part of reviewing courts to permit expansion of FTC authority, and the redefinition of its standard in the Wheeler-Lea Act, the Commission is now enabled to extend the scope of Group I rules. In particular, it attempts to use this technique to eliminate widespread deception by setting up positive rules for quality standards in such industries as textile manufacturing. Co-operation of trade associations in discovering evasion and recommending formal prosecution is a valuable aid in the FTC's policing activities.

THE FTC AS AN ADMINISTRATIVE DEVICE

Viewed in its entirety, the twenty-five-year record of the Commission is a poor one. Its basic defects stem from origins beyond the Commission's control. After 1921 the policy which it was founded to administer was no longer accepted by the political arms of the government, executive and legislative. After 1925 that policy was not accepted by the majority of the FTC itself. Until 1934, judicial hostility was a major factor in its successive disappointments. Underlying these considerations lies the fundamental issue of whether the 1914 policy was not objectively unadministrable by any means. The root problem, in short, was whether restoration and preservation of market structures which would retain the advantages of competition, without encouraging economically ruinous or ethically vicious practices, was conceivably possible without far more comprehensive controls than could be contained within any interpretation of the mild phrase "unfair methods of competition."

To these unescapable weaknesses the Commission added others within its own area of responsibility. Its staff, particularly on the legal side, was for many years generally agreed to be of low quality. It tended to prefer tedious routine to courageous experimentation in administrative techniques. As a quasi-judicial tribunal, the FTC issues public findings of facts and orders which should be akin to the written opinions of appellate courts. In practice they have tended to reproduce the legalistic jargon of the formal complaints

80 FTC, *Annual Report,* 1940, p. 111.

and statutory standards of illegality, with little economic analysis of the practices condemned or legal analysis of the basis for the orders. Findings of the Interstate Commerce Commission, the National Labor Relations Board, and the Securities and Exchange Commission make a marked contrast with these documents. While not wholly responsible for the contemptuous attitude of reviewing courts, the orders have often deserved little better treatment than they received. Nor have the Commissioners ever attempted to compensate for Congress' unwillingness to define their task more explicitly by undertaking themselves a forthright formulation of policy. Had this been done in the early days, more respect might have been forthcoming from the courts. Had it been done with the Trade Practice Conference procedure, the fiasco of 1930 might have been avoided and the Commission would not have forfeited the growing confidence of the business world. The Commission might then have brought to light in sharp contour the precise defects of its legislative authority and appealed more successfully to Congress for remedial amendments. An independent administrative agency is always ultimately controlled by Presidents, who name its members, and Congresses, which supply its funds. But when determined to make full use of its position it can itself become a pressure group of no mean significance among the political forces which make up the context of our legislative process.

In its essence, the 1914 legislation was an attempt to take the burden of formulation and administration of antitrust policy out of the hands of the Department of Justice and the courts and to set up in their stead an independent administrative agency. Commissions of this sort are recognized as an unusual American contribution to administrative technique. In recent years they have been the targets of savage criticism from some quarters and recipients of fulsome praise from others. It must be noted that the scope of the FTC is wider than that of comparable agencies. The Interstate Commerce Commission, the Federal Communications Commission, the Federal Power Commission, the Securities and Exchange Commission, the United States Maritime Commission, and state public utility commissions all deal with a functionally limited portion of the economy. The National Labor Relations Board covers a somewhat wider field horizontally, but its duties are relatively precise: supervision of labor elections and action against specified practices of employers which may discourage independent labor organization

and collective bargaining. Concentration upon administration of a policy already outlined by Congress, or upon policy formation in restricted areas in which the Commissioners can develop unequaled knowledge and acquaintance with all relevant factors, is largely responsible for such success as these bodies have attained.

Federal Trade Commissioners could in no case possess or acquire as intimate an acquaintance with the whole business world as Interstate Commerce Commissioners can with the railroads—or even with all forms of transportation. Their short terms, which have in practice averaged only four and a quarter years, add to this difficulty. Their administrative record has been most successful in the one field where policy is relatively simple and least controversial—that of false advertising and misbranding. Only in this area have FTC requests for further legislative authority been granted by Congress. In the broader task of formulating policies for the maintenance of the competitive structure as a whole, where controversy is all pervading and vital economic interests are at stake, the Commission has been relatively helpless. In setting the FTC this task, Congress was demanding the impossible. An administrative agency is no substitute for fundamental definition of policy. Such an agency can sketch in details and devise methods for accomplishing fixed objectives. The resolution of conflicting interests and pressures into such objectives must take place on the legislative level.

Other characteristics of the FTC as a type of administrative agency are shared with regulatory commissions in general.[81] Chief among them is the fusion of legislative, executive, and judicial functions in one body. As far as the FTC is concerned, the quasi-legislative power has been greatly restricted by the assumption of the courts that it is within their province to define "unfair methods of competition." If the recently altered judicial attitude shifts the balance of this burden back onto the Commission, it may be well advised to attempt from time to time a codification of definitions more precise than the sprawling and unsystematic list published in the annual report. As long as the initial standards laid down by statute remain vague, as to a great extent they must in a field like regulation of competitive practices, occasional codification can be a valuable supplement to the development of law through the slower process of quasi-judicial decision in specific cases. Businessmen would have a clearer notion of their rights and duties. At the same

[81] See above, pp. 53–55.

time, it is incontestable that the main burden of framing such a code should rest with the same body which applies the general standards to particular manifestations of prohibited practices.

FTC procedure in its formal cases has also been severely criticized. Briefly epitomized, it is said that the same group of men, or their immediate subordinates, investigates alleged unfair practices, decides that the evidence warrants issuance of a formal complaint, and then tries a case before itself to decide on the merits of the complaint which it has already once approved. Critics assume that having once committed itself to a public complaint, the Commission will lean heavily toward finding respondents guilty. This alleged prejudice is also taken to justify thoroughgoing judicial review, including re-examination of the evidence on which findings of fact are based, in order to protect respondents' rights. How far such criticisms are valid depends upon the personnel of the Commission and its staff of trial examiners, the extent to which they delegate to subordinates decisions nominally made on their own behalf, and the internal separation of functions between prosecuting and quasi-judicial officers. In the early years of the FTC the Commissioners occasionally displayed a tendency to suppress evidence favorable to respondents and to repeat in formal findings the allegations of the complaint in the same terms, with too little attention to testimony brought out at the trial. They also sometimes permitted a confusion of function between the staff of prosecuting attorneys, whose business it is to press the case against respondents to the utmost, and the trial examiners who are deputies of the Commission in its quasi-judicial capacity. In recent years, however, an absolute division of function has been maintained. Like all Commissions, finally, the FTC is subject to political pressure from legislators and others which would be considered wholly improper if applied to the courts. The procedure has been improved during the last decade, and the large proportion of complaints dismissed indicates that the FTC cannot be considered wholly one sided.

Under the terms of the statute the Commissioners themselves must approve of proposed complaints, as well as final orders, before they are issued. This places a heavy burden upon the five men at the top, whose individual duties are now so time consuming as to make it difficult for them to devote sufficient attention to the basic task of developing an administrative law of unfair competition. The economic damage attendant upon mere publicity of a complaint,

even if it is later dismissed, demands that the preliminary stages of investigation be handled responsibly. On the other hand, if this work were separated from the quasi-judicial function, and from sublegislation, which both require the personal responsibility of the Commissioners, FTC efficiency would benefit and its decisions would be less subject to charges of bias. An approach has been made toward divorcing prosecuting and judging functions by the partial separation of the Chief Trial Examiner's office and staff from that of the examiners and Board of Review who handle the preliminary stages of a case, and the attorneys who argue cases for the Commission. Ample room remains, however, for further delegation of routine functions to responsible members of the Commission staff. Such a reorganization, together with further improvement in the written findings of fact and publication of reasons for dismissal of complaints as well as affirmance, would go a long way toward meeting present criticisms of formal FTC procedure.[82]

Subject to these limitations, the FTC is a form of administrative agency that can contribute substantially to the formation and administration of public policy. It has done so in connection with false advertising, and to a lesser extent through the Trade Practice Conference procedure. Congress itself, however, will have to redefine American policy toward the industrial structure as a whole before any administrative agency can be effective in this wider sphere. One attempt in this direction has been made. Just as the FTC Act tried to place on this Commission the burden of policy formation which the courts had borne unsuccessfully and which Congress would not undertake in 1914, so the National Industrial Recovery Act of 1933 tried to shift it to representative agencies of private business. Before dealing with this major experiment, we must consider the place of those agencies—namely, trade associations—in the American scene, and the extent to which their activities had been affected by previous antitrust policy.

[82] See Attorney General's Committee on Administrative Procedure, Monograph No. 6, *Federal Trade Commission,* S. Doc. 186, 76th Cong., 3rd Sess. (1940).

Chapter Fifteen. TRADE ASSOCIATIONS, CARTELS, AND THE STATE

The American antitrust tradition, as we have shown, was brought into being, in the first place, in response to widespread resentment against a number of outstanding, aggressive, monopolistic combinations. Equally important in their effects upon the working of the national economy, although less dramatic and less productive of moral indignation, are the infinite variety of looser agreements among business units. While retaining their separate existence and much of their freedom of action, business units operating under such agreements co-operate voluntarily in the promotion of common objectives. Pools of various kinds, market-sharing and price agreements among groups of competitors in geographically restricted markets, and other similar methods of limiting competition, are, of course, very old phenomena. We have seen how, well before the passage of the Sherman Act, many such agreements were held to be unenforceable at common law on the ground that they were in restraint of trade and, therefore, against public policy. The ephemeral character of these agreements, due largely to the impossibility of binding recalcitrant or renegade parties to their terms, was chiefly responsible for the search for more certain means of eliminating competition, through trusts, holding companies, and large-scale mergers.

In Germany, where neither common law nor antimonopoly statutes hindered the development of voluntary associations among competitors, they have multiplied apace over the last half century.

Their major purpose, frankly proclaimed, was "stabilization" of their markets through concerted control of prices and output. To such organizations, which show a wide variety of institutional forms and control techniques, the term "cartel" is generally applied. In Great Britain, likewise, no positive antitrust policy has been developed by Parliament, and common-law hindrances to business co-operation have been steadily lessened since 1889. As a result, particularly since Britain's final abandonment of free trade in 1932, trade "Institutes" have been organized over a wide economic area. Like cartels, they seek to eliminate overproduction, to "rationalize" industrial and commercial practices, to control prices, to allocate output, and, as far as possible, to maintain profits.

In this country, the term "cartelization" has always carried an alien and unfavorable connotation. A more rigorous interpretation of public policy by common-law courts, coupled with state and federal antitrust legislation, has outlawed open and avowed agreements among competitors concerning prices and output. On the other hand, the same basic trends producing dissatisfaction abroad with unmodified competition have also obtained here. Improved transportation, mass production, increasing proportions of fixed to variable costs, and the increased severity of the trade cycle lie at the heart of the movement for business self-regulation. Deflected from cartelization by public policy, American businessmen were in no sense ready to forego all attempts at common action short of merger, particularly when the alternative might be cutthroat competition and widespread bankruptcy.

Clearly illegal agreements have often been set up on a secret basis. Participants in such agreements, however, must surmount not only the hindrances of nonenforceability, but also the risk of government prosecution or of triple-damage suits by injured competitors or large consumers. Even under a relatively lenient and ill-equipped Department of Justice and Federal Trade Commission, many secret agreements for price and output limitation break down of their own accord. On the other hand, there is also a wide area of open co-operative activity, ranging from unqualifiedly beneficial and universally approved operations, at one extreme, to a zone of doubtful legality at the other. For such purposes, formal trade associations, generally incorporated, are set up in particular industries or sections of industries. They may be limited in geographical coverage or extend to the nation as a whole.

1. The Trade Association Movement

Although a small number of trade associations flourished at the time of the Civil War, organizations of this sort became common only during the eighteen-seventies and eighties. In this period they concerned themselves almost exclusively with efforts at market control. With few exceptions, they were very short lived. Toward the end of the century, as state and federal statutes came to forbid price and output agreements, a gradual transformation set in. "Constructive co-operation" among competitors for promotion of an industry through product standardization, industrial and commercial research, and like activities, as well as through co-operative lobbying for tariff and other favors, were among their avowed objectives. When the rule of reason [1] was announced by the Supreme Court in 1911, association promoters saw an opportunity to expand their functions. The leader of this new movement was A. J. Eddy, a Chicago lawyer. Under the title *The New Competition,* Eddy set forth a plan for "open competition." Through the systematic interchange and dissemination of statistics on production, sales, prices, costs, and inventories, trade associations were to enable members to formulate their individual commercial policies intelligently, and with due regard to the economic position of their entire industry. The plan proved popular. It was taken up at once by a large number of associations, particularly in steel products, lumber, and textiles.

During the first World War, a further impetus to industrial organization was supplied by the government, when it encouraged formation of trade associations as channels for wartime economic planning. Estimates of the number of such associations at the close of the war vary with definitions of the term, but they run roughly from 1,500 to 2,000. The movement was strongly encouraged by the Department of Commerce during the early nineteen-twenties, and later by the FTC as well. It soon encountered legal difficulties, however, which dampened the enthusiasm of many businessmen. A slow but perceptible decline set in until 1933. In that year, suddenly converted into quasi-public agencies for the administration of the National Industrial Recovery Act, trade associations became almost a *sine qua non* for every American industry. Their number shot up into the high thousands. While declining to

[1] See above, p. 461.

some extent after the termination of the NRA, the number of national trade associations was estimated in 1938 at over 1,000, and state and local associations at about 6,500.

Many trade association activities are not monopolistic either in purpose or effect, and have no relation to antitrust policy. Likewise, of course, numerous monopolistic agreements are not institutionalized under trade associations. Nevertheless, the organization of competitors for co-operation with regard to some purposes has carried with it the threat that co-operation may be extended beyond the border line of illegality. In consequence, trade associations have been the major focus of attention in the application of antitrust policy to loose agreements.

ASSOCIATION ACTIVITIES

The leading activities of trade associations fall into the following seventeen categories: [2]

(1) Government relations, including contacts with administrative agencies and legislative lobbying.

(2) Trade promotion, including market research, industry advertising, and development of new uses for industry products.

(3) Standardization and simplification, including reduction in numbers of product types and sizes, and establishment of quality standards.

(4) Annual conventions of members for the discussion of common problems.

(5) Establishment of accepted trade practices, including elimination of supposedly undesirable methods of competition.

(6) Collection and dissemination of trade statistics relating to business activity, including production, sales, inventories, shipments, and orders.

(7) Employer-employee relations.

(8) Special statistical studies and republication of statistics.

(9) Technical research and advisory service, including operation of research laboratories.

(10) Public relations, designed to promote good will toward the industry as a whole.

(11) Studies of costs and promotion of uniform accounting.

[2] The order of arrangement follows the frequency with which the activities were reported in a recent survey. See Temporary National Economic Committee, *Trade Association Survey*, Monograph No. 18 (1941), pp. 22–26.

(12) Provision of credit information concerning customers.

(13) Traffic and transportation, including advice on routing, handling of freight claims, and promotion of lowered freight rates.

(14) Collection and dissemination of members' prices and bids, including "open price filing."

(15) Commercial arbitration.

(16) Bill collection service.

(17) Information and assistance with regard to registration of patents, trade-marks, designs, and styles.

It is evident that many of these activities are directed solely toward the reduction of costs or the expansion of markets and conflict in no way with antitrust policy. This group includes industrial and commercial research, industry advertising, representation at fairs and expositions, standardization of products and interchangeable parts, simplification of grades and sizes, credit rating of customers, and establishment of arbitration machinery for disputes both within the industry and between members and outsiders. In some of these fields, government encouragement is afforded on a large scale through the Department of Commerce. Other trade association activities, however, may have serious monopolistic implications, depending upon the manner in which they are employed. This is the case, for example, with the promotion by associations of standard cost accounting methods, and the provision of uniform accounting forms. The object may be merely to supply the services of expensive, skilled accountants on a joint basis, and to inform members more accurately of the true state of their affairs. On the other hand, the practice may easily slide over into recommendation of fictitious minima for certain cost elements, arbitrary allocations of overhead costs, or arbitrary profit allowances, thus tending to fix part of the final price regardless of actual variations.

The use of trade associations for interchange of patent rights is likewise subject to possible manipulation for purposes of market control. In industries involving a high degree of mechanization, the number of incidental patents on refinements of the basic processes frequently runs into the hundreds. Under such conditions, manufacturers have sometimes found it convenient to avoid interminable and expensive litigation by pooling their various patents through an association, cross-licensing all the members for their use. Royalties are ordinarily charged, although in the outstanding case of the auto-

mobile industry patents of all members of the pool may be freely used by any of them. Such a pool, far from introducing monopolistic elements into the market, actually reduces them by eliminating the various legally held monopolies on the separate patented processes. On the other hand, a pool may be so administered as to convert separate patent monopolies on processes for producing similar, and therefore competing, commodities, into a single concerted monopoly over the whole of an industry. There may be efforts to extend the patent rights in machinery to control of the market for unpatented products. Only a detailed examination of each case can show whether or not such practices conflict with the general purposes of the antitrust laws.

Trade associations are particularly likely to run afoul of antitrust policy in connection with their statistical services for members. Associations vary widely in their practices in this connection. Prices, production, and sales are the most commonly reported items, but some association statistics also cover costs and inventories. Justification for these services is commonly argued on the ground that adequate knowledge of an industry's economic situation as a whole is essential to intelligent competition. Such knowledge, it is claimed, reduces, rather than creates, market imperfections. In the early years of Eddy's open-price system, for example, lumber dealers were said to be unwarrantably bid down by unscrupulous large buyers, who made false claims of low-price offers from others. In more general terms, it is asserted that the proper planning of a firm's economic policy must, under modern conditions, be made in the light of the industry's entire market prospects, and that co-operative interchange of information alone can afford the basis for reasonable forecasts of those prospects. As is indicated by recently developed economic theory, the arguments for open-price systems assume that the markets are characterized by monopolistic competition—as, in fact, most modern markets are. The issue which then arises for public policy, as long as the fundamental assumptions of the antitrust laws are preserved, is whether particular trade association practices tend to induce price and output policies more nearly resembling those of a pure monopolist than would be likely in the absence of those practices.

Viewed in this light, open-price systems may clearly conflict with antitrust policy. Where the number of competitors is fairly small, systematically acquired information of each other's output and

prices may in itself, without direct agreement or collusive action of any kind, lead them all to restrict output simultaneously in the hope of increased profits. The manner of reporting and the association secretary's comments on the information may increase this tendency. If individual transactions are identified in the reports, the way is open for pressure to be brought against price cutters. Statistics of inventories are even more likely to have a monopolistic effect, since increasing inventories in the industry as a whole suggest curtailment of production if members desire to maintain the price structure. Most questionable of all statistical services are those concerning costs. Circulation of individual costs is rarely permitted by members, while figures for average costs are, in fact, often taken as suggestions for minimum prices. Here, again, the precise method of calculation and transmission to members may be decisive of the effects in actual practice.

Informational activities of trade associations, therefore, may easily be transformed into efforts to control output, prices, and methods of sale and distribution. These services are, in fact, most highly developed where the trade is handled by relatively few sellers. Most associations, moreover, disseminate their information only to members, thus depriving outside sellers and all buyers of the advantages of knowledge and "intelligent competition" which the information is supposed to promote. For these reasons, the Federal Trade Commission has repeatedly suggested that statistical reporting be closely supervised by a public agency, and perhaps even removed to a neutral body not under the control of interested entrepreneurs on only one side of the market.

Outright price and production control is potentially implicit in any scheme of institutionalized co-operation among supposed competitors. Adam Smith once propounded the classic remark that "people of the same trade seldom meet together even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices." [3] Abroad, where law does not forbid, such market control is explicitly sought. Control techniques in this country must be trimmed to meet the limitations of the law; in this respect trade associations are "cartels emasculated by the antitrust laws." [4] The precise extent to which such activities are now forbidden will be considered in the following section of

[3] Adam Smith, *The Wealth of Nations* (Cannan ed., 1904), Vol. 1, p. 130.

[4] A. R. Burns, *The Decline of Competition* (1936), p. 74.

this chapter. Suffice it to note here that associations have, on occasion, attempted directly to establish concerted price and output controls. More commonly, "Codes of Ethics" are utilized to eliminate certain forms of competition. Such codes may, for example, proscribe "sales below cost," a deceptive phrase which conceals serious ambiguities. Its practical results will depend upon the particular cost employed—whether the cost of the most efficient producer, that of the least efficient, that of each producer taken separately, or some average —upon the method of allocating overhead, and upon the allowance, if any, for profit. The codes also frequently seek to eliminate competition in credit terms and other elements going into the composition of actual price. Such provisions arise from co-operative efforts to outlaw "unfair methods of competition," and are often put in final form at FTC Trade Practice Conferences. One objective which has increased in importance in recent years is the limitation of channels of distribution to "legitimate" wholesalers or retailers banded together for protective purposes. To this end, boycotts and other forms of pressure may be brought to bear on manufacturers. In addition, groups like the National Association of Retail Druggists and the National Retail Grocers' Association have taken the lead in promoting legislation against price discrimination, for legalization of resale price maintenance, and for chain store taxation, in the hope of discouraging the growth of mass distributors.

Activities of this sort are often claimed to help "stabilize" industry not only in the interests of entrepreneurs, but in the general interest as well. This issue goes to the heart of traditional antitrust policy, which purports to depend upon competition itself as a stabilizing force in the economic system. The term "stabilization" also conceals an ambiguity, for entrepreneurs organized in trade associations have shown themselves primarily interested in stabilization of profits and prices, while it may be forcefully argued that the general interest lies rather in stabilization of output and employment, and at the lowest prices consistent with that end. Differences of opinion on this score are still in active ferment as possible revision of antitrust policy is being considered.

2. Trade Associations and Loose Agreements Under the Antitrust Laws

Application of antitrust policy to loose agreements is based almost entirely upon the Sherman Act, which has been discussed in gen-

eral terms in Chapter 13. Unfair methods of competition, outlawed by the Federal Trade Commission Act, have been construed to include restraints of trade, and the Commission has instituted many suits against such restraints. So far as the substance of the law is concerned, however, the FTC has merely followed the judicial construction of the Sherman Act. Thus detailed policy shaping was left, until 1933, wholly in the hands of the courts. Statutory modifications by Congress were all by way of exception. The abortive attempt in the Clayton Act to exclude labor organizations from the operation of the law has been described in Chapter 7. Shipping "conferences" were exempted in 1916, subject to United States Shipping Board approval. Export trade associations were exempted under the Webb-Pomerene Export Trade Act of 1918. Railroad consolidations under I.C.C. approval were exempted in the Transportation Act of 1920 and marine insurance in the Ship Mortgage Act of the same year. Telephone companies were also permitted, after 1921, to consolidate with I.C.C. approval. The Capper-Volstead Act of 1922 authorized agricultural marketing co-operatives, but subject to supervision by the Secretary of Agriculture to prevent them from raising prices "unduly." From 1913 to 1923, Congress sought to make partial exemptions indirectly, by providing in Department of Justice Appropriation Acts that no funds be spent in prosecuting labor organizations formed to improve wages, hours, or working conditions, for any act "not in itself unlawful," or co-operative associations of farmers designed "to obtain and maintain a fair and reasonable price for their products." Despite this not inconsiderable number of individually excepted industries, Congress showed no disposition to modify the law in its general application.

In striking contrast with their attitude toward mergers, the courts have applied the law to loose agreements, with a few notable exceptions, with consistent and marked severity. Emphasis is laid here on economic effects rather than on motives. Power to control, or even merely to affect the market—not abuse of that power—is the criterion of illegality. Nor must an agreement include all or almost all of the firms in a given market to fall within the ban. The rule of reason has some significance in this field, as will be indicated, but its application is very limited. As a result, while a mere handful of close consolidations has been dissolved or prevented since the first World War, by virtue of the antitrust laws, associations and agreements in restraint of trade have been successfully at-

tacked by the dozens. It is no cause for wonder, therefore, that during the twenties proponents of "industrial self-government" and "co-operative stabilization of industry" became bitter critics of the Sherman Act, and pled for amendments to permit "reasonable" executive dispensations or even for outright repeal. It was frequently claimed at that time, and with reason, that the combination of lax construction against combinations and strict construction against agreements actually promoted trustification—that the courts had in this way converted the Sherman Act into a positive force for the defeat of its original objectives. This claim had the support of Justice Brandeis, who suggested it in a dissent in 1921. Although it was disputed by Chief Justice Hughes twelve years later, the trend of the cases supports Brandeis's viewpoint.

Explanation of the contrast lies partly in legal tradition, partly in judicial psychology. Long-established doctrines of conspiracy were more clearly applicable to loose agreements than to mergers. Emphasis could be placed exclusively on Section one of the Sherman Act, with its test of "restraint of trade," thereby avoiding the narrow traditional legal meaning of "monopoly." It has sometimes been suggested that the underlying reason lies in the economic considerations that a full-fledged consolidation may lead to economies of large-scale production and enhanced efficiency, with market control as a mere incident, whereas loose agreements are solely concerned with the latter purposes and are hence less desirable. There is little evidence that courts have given this view much attention. A more probable basis lies in the differing effects on established property relationships consequent upon successful government attack. Dissolution of an important trust, to be effective, may require an economic upheaval in the industry concerned; termination of an agreement or dissolution of a trade association is a relatively simple matter.

PRICE AND OUTPUT AGREEMENTS

Until the *Appalachian Coals* case of 1933, the law against direct price or output agreements was rigid and unyielding. It will be recalled that the decision against the Addyston Pipe Pool, in 1899, was the first government victory in the Supreme Court under the Sherman Act in the industrial field.[5] The agreement in that case,

[5] See above, pp. 455–456.

with its provisions for sharing territory and fixing prices, together with the practice of artificial bidding to retain the mask of competition, was clearly in "restraint of trade" under any possible definition. Counsel for the pool argued that the prices fixed were reasonable, but the Court rejected this claim as untrue and in any event irrelevant, since the members had power to charge unreasonable prices. Price fixing and pooling of earnings through a common sales agency were also held illegal in a suit involving the wallpaper association in 1909.[6]

The law restrains concerted price fixing by buyers as well as sellers.[7] An agreement to fix prices need not be explicit to fall within the ban; trade association activities leading indirectly to the same result are equally forbidden. Thus, the FTC was sustained in 1923 in ordering an association of paper dealers to cease distributing price lists actually used by members in their interstate sales, even though association penalties were levied only against price cutting in intrastate commerce.[8]

When he propounded the rule of reason in 1911, Chief Justice White did not distinguish between close combinations and loose agreements. Some trade association lawyers forecast a legalization of agreements to prevent "ruinous competition," as long as they curtailed only "overproduction," or set only "reasonable" prices. These hopes were destined to disappointment. Following the dominant trend of the American common-law cases in this field, the courts consistently refused to sustain concerted control of output or prices, no matter how good the motives or how allegedly beneficent the results. The issue was raised in unambiguous form in the *Trenton Potteries* case in 1927.[9] Manufacturers and distributors of 82 per cent of the pottery bathroom fixtures produced in this country, associated in the Sanitary Potters' Association, had admittedly fixed prices and limited sales to selected jobbers. The case was brought under the criminal provisions of the Sherman Act. In the trial court, the judge had refused to submit to the jury the questions of reasonableness of the prices and good intentions of the members. He

[6] *Continental Wallpaper Company* v. *Voight & Sons Co.*, 212 U.S. 227.

[7] *Swift & Co.* v. *United States*, 196 U.S. 375 (1905); *Live Poultry Dealers' Protective Association* v. *United States*, 4 F. (2d) 840 (1924).

[8] *Federal Trade Commission* v. *Pacific States Paper Trade Association*, 273 U.S. 52 (1927).

[9] *United States* v. *Trenton Potteries Co.*, 273 U.S. 392 (1927).

maintained that these factors were irrelevant to the question of guilt under the law, and that "an agreement on the part of the members of a combination controlling a substantial part of an industry, upon the prices which the members are to charge for their commodity, is in itself an undue and unreasonable restraint of trade and commerce." He was fully sustained by the Supreme Court, which divided five to three. Speaking through Justice Stone, the majority said:

> It does not follow that agreements to fix or maintain prices are reasonable restraints and therefore permitted by the statute, merely because the prices themselves are reasonable. Reasonableness is not a concept of definite and unchanging content. Its meaning necessarily varies in the different fields of the law. . . . It cannot be doubted that the Sherman Law and the judicial decisions interpreting it are based upon the assumption that the public interest is best protected from the evils of monopoly and price control by the maintenance of competition. . . .
>
> The aim and result of every price-fixing agreement, if effective, is the elimination of one form of competition. The power to fix prices, whether reasonably exercised or not, involves power to control the market and to fix arbitrary and unreasonable prices. The reasonable price fixed today may through economic and business changes become the unreasonable price of tomorrow. . . . Moreover, in the absence of express legislation requiring it, we should hesitate to adopt a construction making the difference between legal and illegal conduct in the field of business relations depend upon so uncertain a test as whether prices are reasonable—a determination which can be satisfactorily made only after a complete survey of our economic organization and a choice between rival philosophies.

It is to be noted, also, that while the "trust" cases establish a test of substantial dominance of the market, association agreements have been condemned on the basis of "substantial control," which in practice may mean as little as 30 per cent. As one judge has put it, the law forbids "all agreements preventing competition in price among a group of buyers, otherwise competitive, if they are numerous enough to affect the market." [10]

Two exceptions stand out against the well-crystallized pattern of the law during the post-World War I period. The Supreme Court

[10] Learned Hand, J., *Live Poultry Dealers' Protective Association* v. *United States*, 4 F. (2d) 840, 842 (1924). Cf. also *Indiana Farmers' Guide Publishing Co.* v. *Prairie Farmer Publishing Co.*, 293 U.S. 268 (1934).

upheld in 1918 a rule of the Chicago Board of Trade, the world's leading grain market, which forbade price changes on grain "to arrive" in the period between the close of one market session and the next day's opening, although actual trading during these hours was common. Here the rule of reason was applied. No showing had been made by the government of any effect upon prices in general, or the amount of grain shipped. "The true test of legality," said Justice Brandeis, "is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition." [11] The Court found that the rule substituted a public market for private bidding, brought buyers and sellers into more direct relations, and otherwise improved the market. On its facts, therefore, the case is hardly an important dent in the law, and the words of the Court have been pled unsuccessfully in subsequent cases.

Similarly, in 1923, the Court validated an agreement between all the manufacturers in the rapidly dying handblown glass industry and their skilled workers, which divided the manufacturers into two groups and allocated the full labor supply to each in turn for a half year. Since prices were set by the competing machine-made product, which supplied 95 per cent of the market, and the number of trained blowers was limited, the Court saw "no combination in unreasonable restraint of trade in the agreements made to meet the short supply of men." [12] The unique circumstances made the case inapplicable as a precedent in the general field of trade association activity.

BOYCOTTS

Decisions on other forms of agreements turn largely on the issue of how far in fact they tend to restrict competition. As their relation to price and output control becomes more uncertain and indirect, the law assumes less clarity. Concerted maintenance of uniform terms of sale, including credit allowances, discounts, etc., is a common adjunct to price-fixing schemes and is commonly enjoined along with them. Agreement on an important element of price, even in the absence of agreement on price itself, is illegal. Closely related to price and output controls are attempts through concerted

[11] *Chicago Board of Trade* v. *United States,* 246 U.S. 231 (1918).

[12] *National Association of Window Glass Manufacturers* v. *United States,* 263 U.S. 403 (1923).

action to modify the channels of distribution in favor of a particular group. The leading case, decided in 1914, forbade an association of retail lumber dealers to circulate black lists of wholesalers selling direct to consumers, as part of a system of boycott to force the entire trade through the hands of the retailers.[13]

The ban extends both to primary boycotts, in which only the association members refuse to deal with the "illegitimate" manufacturer or customer, and to secondary boycotts, in which the members attempt to induce others also not to deal. Suits against associations of wholesalers or retailers engaged in such protective boycotts make up a considerable portion of the total antitrust litigation. In most instances, boycotts are designed to favor a class of distributors which stands in danger of being short-circuited in the distributive process. The law also forbids associated manufacturers to refuse to sell to particular dealers. Nor may a manufacturers' association set onerous or unreasonable terms which dealers would have to fulfill in order to be accepted as channels of distribution.[14]

The motion-picture industry, dominated by the "Big Eight" producer-distributors and their trade association, the Motion-picture Producers and Distributors of America, has long been a focus of agitation and litigation in this field. The eight leading firms control directly over half the theaters in the country. They produce four fifths of the feature films. Smaller independent producers and independent theater owners have complained chronically of organized discrimination and arbitrary treatment from Hollywood. In 1923, an exhibitor obtained relief against a boycott instituted because he obtained films from certain distributors, but refused to buy from others.[15] Seven years later the Supreme Court enjoined the distributors from refusing to lease to exhibitors except under a standard form of contract containing rigid provisions for compulsory arbitration of trade disputes.[16] That the provisions in this contract had been adopted by the FTC as Group II rules in a Trade Practice Conference was considered irrelevant. The Court also forbade

[13] *Eastern States Retail Lumber Ass'n.* v. *United States,* 234 U.S. 600 (1914).

[14] Concerted refusal to deal is justified only in pursuance of unqualifiedly approved objectives. A recent case sustains such refusal in connection with dress manufacturers' efforts to suppress design piracy. *William Filene's Sons Co.* v. *Fashion Originators' Guild of America,* 90 F. (2d) 556 (1937). Early in 1941 cases on association efforts to suppress design piracy were pending before the Supreme Court.

[15] *Binderup* v. *Pathé Exchange,* 263 U.S. 291 (1923).

[16] *Paramount Famous Lasky Corp.* v. *United States,* 282 U.S. 30 (1930).

concerted exaction from theater purchasers of onerous standard credit requirements, which had the effect of "excluding them from the opportunity to deal in a free and untrammeled market." [17] A further provision of the standard contract, in effect prohibiting double-feature programs, was struck down in 1936.[18] In the following year the government also secured an injunction against conditions in licensing agreements on second-run pictures which required minimum admission prices and forbade the use of these films as part of a double-feature program.[19]

The final stage to date in these successive proceedings, in which the Department of Justice alone has made seventeen attacks on the "Big Eight," was a bill in equity filed by the Department in 1938, seeking to divorce production and exhibition entirely, in the hope "that the theaters of the country will become a free, open, and untrammeled market to which all producers may have access for the distribution and licensing of films based upon merit." [20] After two years of continuous negotiation in an effort to reach an agreed settlement, five of the eight companies accepted a consent decree in November, 1940.[21] The decree did not require the divorcement of exhibition from production and distribution. "Blind selling," however, was prohibited; exhibitors were to be given an opportunity of seeing all films before contracting for their purchase, and films might no longer be sold before completion. "Block booking" was severely curtailed. Pictures might not be sold in groups of more than five. The position of exhibitors with respect to cancellation rights was substantially improved. The decree also set up an elaborate arbitration system to deal with intraindustry disputes.

In all the boycott cases, it must be noted, it is the fact of acting in concert, not the action itself, which is illegal. When it is also con-

[17] *United States* v. *First National Pictures,* 282 U.S. 44 (1930).

[18] *Vitagraph* v. *Perelman,* 95 F.(2d) 142 (1936). See also *Youngclaus* v. *Omaha Film Board of Trade,* 60 F.(2d) 538 (1932), forbidding concerted agreement on a minimum period of protection for first-run theaters against exhibition of the same films by other theaters.

[19] *United States* v. *Interstate Circuit, Inc.,* 20 F.Supp. 868 (1937); affirmed by the Supreme Court in a five to three decision, 306 U.S. 208 (1939).

[20] *Annual Report of the Attorney General,* 1938, p. 322. The unsuccessful attempt of the FTC to proscribe block booking has been described above, on p. 492. It is interesting to note that the major baseball leagues are freed from the limitations of the antitrust laws on the ground that they are not engaged in interstate commerce. *Federal Base Ball Club of Baltimore* v. *National League,* 259 U.S. 200 (1922).

[21] Negotiations were being continued with the three remaining respondents.

sidered that an association need cover only a relatively small portion of the national market to fall within the law, the inducement to close consolidation is evident.

PATENT POOLING

The attitude of the courts under the antitrust laws toward patent pooling is based on essentially similar principles. The law is complicated by virtue of the legal monopoly rights inherent in a patentee acting alone, and by the desirability of pooling in many instances. In 1912, in the *Bathtub* case, it was established that an association of manufacturers producing the dominant share of an industry's output might not employ a patent agreement as a means of eliminating price competition.[22] One of the most important antitrust actions of the last decade led in 1932 to the Radio Consent Decree, divorcing the Radio Corporation of America from the General Electric and Westinghouse Companies, and forbidding exclusive patent licenses. Pooled patents covering an immense number of radio tubes and circuits were thus made available to independent manufacturers.

On the other hand, the Supreme Court in 1931 drew the line on the other side of a patent pool among manufacturers producing gasoline by the "cracking" process.[23] The amount of royalty on licenses to other manufacturers was fixed by the agreement, and the royalties themselves were pooled and divided in stated proportions. The government claimed that the pooling of royalties eliminated competition in the licensing of outside manufacturers, and that the royalty fees themselves were excessive, thereby restraining trade in "cracked" gasoline. To this the Court replied, speaking through Justice Brandeis, that such agreements were contrary to the Sherman Act only when used to restrain trade unreasonably by a group effectively dominating an industry. The defendants here controlled only 55 per cent of the total "cracking" capacity, and their proportion was not growing at the expense of outsiders using other processes. "Cracked" gasoline, moreover, was only 26 per cent of the total gasoline output, and was indistinguishable from other gasoline; the patent pool therefore covered only 14 per cent of all gas-

[22] *Standard Sanitary Manufacturing Co.* v. *United States,* 226 U.S. 20 (1912). Cf. also *United States* v. *Motion Picture Patents Co.,* 225 Fed. 800 (1915); *American Equipment Co.* v. *Tuthill Building Material Co.,* 69 F. (2d) 406 (1934).

[23] *Standard Oil Co. (Indiana)* v. *United States,* 283 U.S. 163 (1931).

oline produced. In the sale of gasoline, finally, the defendants competed with each other and with numerous outsiders. Stress was laid upon the desirability of patent interchange in general, as a means of avoiding litigation which might frustrate technical progress. Here, then, the rule of reason was applied in a fashion closely approximating the rule in combination cases, for the 55 per cent control of "cracked" gasoline was well beyond the proportion required to invalidate concerted action in other loose agreement cases.

The illegality of the use of patents as an indirect means of achieving price control over products not within the patent monopoly was recently reaffirmed by the Supreme Court in a case involving the Ethyl Gasoline Corporation.[24] The Ethyl Corporation, jointly owned by Standard Oil of New Jersey, General Motors, and Du Pont, possessed a legal patent monopoly on the use of tetraethyl lead fluid for producing "high-test" gasoline. Almost all the leading refiners were licensed to mix the fluid with their gasoline, but they were permitted to sell only to jobbers licensed by Ethyl. The licensing system required the maintenance of a specified price differential between "regular" and "ethyl" gasoline and limited the channels of distribution for the "ethyl" product. Jobbers' licenses were revocable by the Ethyl Corporation at will. Jobbers were in practice refused licenses if they failed to conform to the marketing policies and prices posted by the major oil refiners. Thus, the patent on "ethyl" fluid was used as a means of controlling general gasoline prices and marketing methods. A unanimous Court condemned the practice. In the words of Justice Stone:

> by the leverage of its licensing contracts resting on the fulcrum of its patents [the Ethyl Corporation] has built up a combination capable of use, and actually used, as a means of controlling jobbers' prices and suppressing competition among them. It seems plain that this attempted regulation of prices and market practices of the jobbers with respect to the fuel purchased, for which appellant could not lawfully contract, cannot be lawfully achieved by entering into contracts or combinations through the manipulation of which the same results are reached by the exercise of the power which they give to control the action of the purchasers. Such contracts or combinations which are used to obstruct the free and natural flow in the channels of interstate commerce of trade even in a patented article, after it is sold by the patentee or his licensee, are a violation of the Sherman Act.

[24] *Ethyl Gasoline Corporation* v. *United States*, 309 U.S. 436 (1940).

Patent pooling presents an unusually difficult enforcement problem to antitrust officials because of the complexity of factual situations and the consequent expense of supervision, investigation, and court trials. The Department of Justice has recently presented before the Temporary National Economic Committee, in dramatic fashion, the contrast between an open patent pool which encourages competition, in the automobile industry, and the restrictive use of patent control, in the glass container industry.[25] The implicit conflict between patent policy and antitrust policy has suggested the possibility of modifying the patent privilege in an effort to prevent abuses, perhaps through administrative supervision of cross-licensing arrangements by the FTC.

OPEN-PRICE REPORTING

Of all the trade association activities which have been questioned under antitrust laws, none has received closer attention than the dissemination of statistics in accordance with Eddy's proposals for the "new competition." The popularity of "open competition," and its encouragement by the government during the first World War, made it at one time the most characteristic single trade association function. The practice was tested in the Supreme Court between 1921 and 1925 in four major cases, the first two resulting in adverse decisions and the subsequent pair showing a more sympathetic attitude.

The *Hardwood* case, decided in 1921,[26] dealt with the most comprehensive of the plans. Producers of one third of the American hardwood lumber output organized an association at the close of the war, focused around the interchange of statistical information. Each member submitted daily reports of shipments, monthly reports of production and inventories, and price lists. These data were collated by the association's manager of statistics, who then sent out to members: (1) monthly reports of production and inventories, indicating separately each member's figures; (2) weekly reports of sales and shipments, including names of purchasers; (3) monthly summaries of price lists; and (4) an interpretative market report letter. The association also held frequent formal meetings, at which market prospects were discussed. During the meetings, a question-

[25] Temporary National Economic Committee, *Hearings on Concentration of Economic Power,* Part 2, *Patents* (1939).

[26] *American Column and Lumber Co.* v. *United States,* 257 U.S. 377 (1921).

naire was circulated asking for members' estimated future production, expected shutdowns, and observations on the future outlook in general. There was no explicit agreement on either prices or production. A majority of six members of the Supreme Court, speaking through Justice Clarke, looked upon the association's record with the utmost suspicion. To them, the systematic revelation of the most intimate details of day-to-day business transactions to nominal competitors suggested *ipso facto* implied collusion in price and output policy. In addition, the Court found, in fact, that meetings and market reports were studded with repeated warnings against "overproduction," and with a number of suggestions, hardly veiled, for price maintenance or increase. The majority inferred from these circumstances that the extremely high prices of 1919 were caused, in part, by association activities as well as by the obstacles to logging occasioned by unusually wet weather. They condemned this plan for "open competition," therefore, as a "misleading misnomer," finding it in both purpose and effect a scheme to restrict production, and hence illegal.

The case is especially notable for the utter divergence of opinion between the Court's majority and minority. Justice Holmes wrote a short dissent, and also concurred in a longer defense of the plan by Justice Brandeis. The latter could see no coercion in the scheme, no loss of freedom of action on the part of anyone. In his opinion:

> It tends to promote all in competition which is desirable. By substituting knowledge for ignorance, rumor, guess, and suspicion, it tends also to substitute research and reasoning for gambling and piracy, without closing the door to adventure or lessening the value of prophetic wisdom. In making such knowledge available to the smallest concern, it creates among producers equality of opportunity. In making it available, also, to purchasers and the general public, it does all that can actually be done to protect the community from extortion. If, as is alleged, the Plan tends to substitute stability in prices for violent fluctuations, its influence, in this respect, is not against the public interest. The evidence in this case, far from establishing an illegal restraint of trade, presents, in my opinion, an instance of commendable effort by concerns engaged in a chaotic industry to make possible its intelligent conduct under competitive conditions.

The dissenters also argued that "surely Congress did not intend by the Sherman Act to prohibit self-restraint." It might well be replied, however, that concerted self-restraint is the sum total of any

price or output agreement. The majority of the Court held far more closely in this case to an economic view of the meaning of competition than did the dissenters. But the real rationale of the dissenting view was not the desire merely to maintain competition as such, but rather the desire to preserve the open door of opportunity and, above all, the fear of bigness. It was here that Justice Brandeis made his celebrated comment to the effect that so strict an attitude toward loose agreements might well encourage consolidation. Here the Court had struck down an agreement among members of an association representing a smaller proportion of the industry than either the United States Steel or the United Shoe Machinery Corporations, both so recently upheld by the Court. Brandeis concluded:

> May not these hardwood lumber concerns, frustrated in their efforts to rationalize competition, be led to enter the inviting field of consolidation? And, if they do, may not another huge trust, with highly centralized control over vast resources, natural, manufacturing, and financial, become so powerful as to dominate competitors, wholesalers, retailers, consumers, employees and, in large measure, the community?

Two years later, the Court enjoined statistical interchanges among manufacturers of "a very large part" of the country's linseed oil, cake, and meal.[27] Association members supplied to a central bureau: (1) their regular price lists; (2) telegraphic advice of price concessions from those lists, with names of purchasers and exact terms offered; (3) a daily report of all sales; and (4) a monthly report of inventories. They bonded themselves heavily for observance of the agreement and arranged monthly meetings subject to penalties for nonattendance. Whenever a member bid unsuccessfully for a sale, he could have the entire industry circularized at once through the bureau, to learn which member had made the sale. The implied sanctions against price cutting appeared to the Court an abnormal departure from competitive methods, which "took away [the manufacturers'] freedom of action by requiring each to reveal to all the intimate details of its affairs." The plan was unanimously declared unlawful.

The *Hardwood* and *Linseed* cases have never been overruled. Reporting of individual transactions under an open-price system is still illegal. Nonetheless, a marked shift in approach was evinced in two cases decided simultaneously in 1925, dealing with associations

[27] *United States* v. *American Linseed Oil Co.*, 262 U.S. 371 (1923).

in the maple flooring and cement industries. The Court was again divided six to three, the minority being drawn from the erstwhile majority. The Maple Flooring Manufacturers' Association represented producers of about 70 per cent of the annual output. Its predecessor associations had at one time pooled members' sales, and later fixed minimum prices, but these activities had been abandoned. Its statistical service was now limited to: (1) statements of average costs of all members, computed as carefully as possible, but necessarily involving an arbitrary element in distributing rough lumber costs among types of finished flooring; (2) a freight rate booklet based on a point very close to the actual shipping points; and (3) summaries of sales, prices, and inventories, which, in contrast to the previously described schemes, did not identify individual members. The information was sent to the Department of Commerce and the Federal Reserve Banks, and was available to the public. There were also regular meetings of members, at which market conditions and other topics were considered, but, on advice of counsel, future prices were never discussed.

Viewing the operation of the plan with a sympathetic attitude in complete contrast to that in the *Hardwood* case, the Court held that these activities did not necessarily lead, and had not in fact led, to concerted action on prices or production.[28] That "the ultimate result of their efforts may be to stabilize prices or limit production through a better understanding of economic laws and a more general ability to conform to them" was conceded, but it was judged to be within the law. The emphasis now was on the desirability of the widest dissemination of information, which "tends to stabilize trade and industry, to produce fairer price levels, and to avoid the waste which inevitably attends the unintelligent conduct of economic enterprise." The *Cement* case[29] was decided on essentially similar grounds, complicated by peculiar industry characteristics which justified co-operative efforts to prevent fraud by consuming contractors.

THE APPALACHIAN COALS DECISION

The position of loose agreements under the antitrust laws before 1933 may be simply summarized. Co-operation as such was

[28] *Maple Flooring Manufacturers' Association* v. *United States*, 268 U.S. 563 (1925).

[29] *Cement Manufacturers' Protective Association* v. *United States*, 268 U.S. 588 (1925).

unobjectionable. When carried on in pursuit of desirable ends, like increased knowledge of market conditions, or avoidance of patent litigation, it was to be permitted even if price and output controls were thereby made more feasible. There, however, the line was sharply drawn. Concerted price and output controls themselves, explicit or implicit, were outside the law. For them, there was no rule of reason; on this point the *Trenton Potteries* case seemed conclusive. Yet businessmen in many industries wanted precisely that which was so unambiguously forbidden. Occasional complaints against the antitrust laws, always noticeable during the twenties, became a thunderous chorus with the onset of the Great Depression after 1929. Harassed competitors, desperately struggling to keep afloat in the face of declining demand, looked upon "cutthroat competition" as one potent cause for the fatal spiral of decreasing prices and income. Businessmen pled for "reasonable" co-operation, not to exploit the public, but merely to "adjust production to demand" and "keep prices above costs." Arguments heretofore made in the chronically "sick" industries, like bituminous coal and cotton textiles, were now applied more generally, as virtually all industries became "sick." Shortly before Congress responded to this plea with the NIRA of 1933, to the great surprise of many skilled antitrust lawyers, the Supreme Court handed down a decision which appeared to reverse much that had seemed firm and unshakable in antitrust law interpretation.[30]

Appalachian Coals, Incorporated, was an exclusive selling agency set up by 137 producers of soft coal. Their output was 12 per cent of the total east of the Mississippi, and 54 per cent of the production of the Appalachian fields. They provided an appreciable share of the supply for Eastern and Southeastern markets, ranging from 9 per cent in the Northeast to 96 per cent in South Carolina. For a number of reasons beyond its control, the industry had suffered from heavy excess capacity ever since the first World War. Oil, natural gas, and hydroelectric power were increasingly successful rivals in shipping, domestic heating, and industry. Coal-burning equipment had been made more efficient. The Court accepted estimates of overcapacity amounting to about 40 per cent.

Unlike anthracite, which is found only in a limited area and is controlled by a few closely knit producers, bituminous coal is widely

[30] *Appalachian Coals, Inc.* v. *United States,* 288 U.S. 344 (1933).

spread and mined by hundreds of separate firms. Declining demand had led to chronic bankruptcies, to wage cuts often below the level of subsistence, to heavy relief burdens on local communities, and to ruthless competitive practices. Many of the consumers were large and well organized, and pushed their bargaining advantage to the limit. The "sickness" of the bituminous coal industry was universally recognized. Conferences between coal operators and government officials had evolved the proposal for regional sales agencies as a partial solution to the problem. The Department of Justice felt itself unable to approve of the plan, and this case arose as a test of its validity under the Sherman Act.

In the District Court, the association was rebuffed.[31] A well-reasoned opinion pointed out that while the association was unable to exercise monopolistic control in any market, because of competition both actual and potential, it would handle a sufficient quantity to affect prices appreciably. There was no intent to restrict production. Price competition among the members themselves, however, was, of course, completely eliminated. Under the law as thus far interpreted, therefore, the plan could not be upheld. The judges declared their sympathy with the motives behind the program and their appreciation for the frank and open manner in which it was put forward. But modification of the Sherman Act, they thought, was a matter for Congress and not for the courts.

The Supreme Court displayed no such modesty about the limits of the judicial function. The Sherman Act was declared to possess "a generality and adaptability comparable to that found to be desirable in constitutional provisions." Emphasizing the distressed condition of the industry, the known overcapacity, the extent of remaining outside competition, and the clear likelihood of new competition if prices were raised unduly, the Court decided in favor of the association by an eight to one majority. It had not been shown, they felt, that there would be any effect on prices "which in the circumstances of this industry will be detrimental to fair competition." Chief Justice Hughes continued:

> A co-operative enterprise, otherwise free from objection, which carries with it no monopolistic menace, is not to be condemned as an undue restraint merely because it may effect a change in market conditions, where the change would be in mitigation of recognized evils and would not im-

[31] *United States* v. *Appalachian Coals, Inc.*, 1 F. Supp. 339 (1932).

pair, but rather foster, fair competitive opportunities. Voluntary action to rescue and preserve these opportunities, and thus to aid in relieving a depressed industry and in reviving commerce by placing competition upon a sounder basis, may be more efficacious than an attempt to provide remedies through legal processes. The fact that the correction of abuses may tend to stabilize a business or to produce fairer price levels does not mean that the abuses should go uncorrected or that co-operative endeavor to correct them necessarily constitutes an unreasonable restraint of trade.[32]

The Court also went out of its way to reject explicitly the doctrine that the rule of reason should be applied less generously to loose agreements than to close combinations. Chief Justice Hughes declared in this connection:

We know of no public policy, and none is suggested by the terms of the Sherman Act, that . . . those engaged in industry should be driven to unify their properties and businesses in order to correct abuses which may be corrected by less drastic measures. . . . The question in either case is whether there is an unreasonable restraint of trade or an attempt to monopolize. If there is, the combination cannot escape because it has chosen corporate form, and, if there is not, it is not to be condemned because of the absence of corporate integration.

The ultimate effects of this decision on the law were by no means clear. The unusual facts of the case suggested that the outcome might be attributed to the catastrophically depressed state of the coal industry. Alternatively, it might be argued that substantial outside competition was a sufficient defense in any antitrust suit. The assimilation of the law of trade associations to that of mergers might work in either direction. Thus, in its suit against the Aluminum Company, the government has argued that the *Appalachian Coals* and *Trenton Potteries* decisions, taken together, mean that power to control a market is illegal irrespective of the form of combination.[33] In any event, by its wider interpretation of the Act, the Supreme Court seemed to give to the judiciary added discretion in the formation and application of public policy. It now appeared open to the courts to hold that, under certain circumstances, price-fixing agreements would not be considered "detrimental to fair

[32] *Appalachian Coals, Inc.* v. *United States,* 288 U.S. 344, 373–374 (1933).

[33] *United States* v. *Aluminum Co. of America,* Equity No. 85–73, in the District Court for the Southern District of New York, *Brief for the United States on the Meaning of the Sherman Act,* September 21, 1938.

competition." Thus, the issue was again posed of how far the cumbrous process of intermittent regulation by prosecution and judicial decision could serve satisfactorily the ends of public policy, once the faith in competition, and in consistent prohibition of all restraints upon competition, was abandoned.

Since 1933, two further major Supreme Court decisions on price-fixing agreements have substantially narrowed the significance of the *Appalachian Coals* case. The first, which condemned the operations of the Sugar Institute, affords an excellent illustration of the complexity of antitrust prosecutions in this field; it is discussed in detail in the following section of this chapter. The second, handed down in the spring of 1940, marks a milestone in the development of the law, for it emphatically reasserted the opposition of the Sherman Act to market controls.

THE MADISON OIL CASE

The *Madison Oil* case [34] (so called because the trial was held in the district court at Madison, Wisconsin) was a criminal prosecution begun in 1936 against the major oil companies selling gasoline in the Midwestern states. The companies were charged with conspiracy to raise tank-car gasoline prices, and indirectly to raise prices at retail, through a concerted program of buying "surplus" gasoline from independent refiners in order to eliminate the pressure of this "surplus" on the market. The defendants admitted the buying program, but claimed that it had had the approval of the government during the NIRA period and the acquiescence of government officials after the termination of the NIRA. Such effect as the program had on prices, they asserted, was a mere incident to the major purpose of eliminating the destructive competition of "distress" gasoline. Under the rule of the *Appalachian Coals* case, they argued, this was a reasonable and legitimate operation clearly permitted by the antitrust laws.

The case was complicated by numerous procedural technicalities and intricate issues of fact which need not concern us here. A jury conviction of almost all the defendants was reversed by the circuit court of appeals on issues of law, but subsequently affirmed on

[34] *United States* v. *Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940). The lower court decisions are reported at 23 F.Supp. 937 (1939) and 105 F.(2d) 809 (1939).

appeal to the Supreme Court by a majority of five to two. The major importance of the decision lies in the restatement of the law by that Court, speaking through Justice Douglas. The opinion relied heavily upon the precedent of the *Trenton Potteries* case. The *Appalachian Coals* decision was sharply distinguished, on the ground that neither intention nor power to fix prices had been shown in that case, whereas here the oil companies in their buying program "had as their direct purpose and aim the raising and maintenance of spot market prices and of prices to jobbers and consumers . . . by the elimination of distress gasoline as a market factor."

The suggestion that "reasonable" price fixing might be permissible was emphatically rejected. The words of the Court warrant quotation at length:

> Thus for over forty years this Court has consistently and without deviation adhered to the principle that price-fixing agreements are unlawful *per se* under the Sherman Act and that no showing of so-called competitive abuses or evils which those agreements were designed to eliminate or alleviate may be interposed as a defense. . . .
>
> The elimination of so-called competitive evils is no legal justification for such buying programs. The elimination of such conditions was sought primarily for its effect on the price structures. Fairer competitive prices, it is claimed, resulted when distress gasoline was removed from the market. But such defense is typical of the protestations usually made in price-fixing cases. Ruinous competition, financial disaster, evils of price cutting and the like appear throughout our history as ostensible justifications for price fixing. If the so-called competitive abuses were to be appraised here, the reasonableness of prices would necessarily become an issue in every price-fixing case. In that event the Sherman Act would soon be emasculated; its philosophy would be supplanted by one which is wholly alien to a system of free competition; it would not be the charter of freedom which its framers intended.
>
> The reasonableness of prices has no constancy due to the dynamic quality of business facts underlying price structures. Those who fixed reasonable prices today would perpetuate unreasonable prices tomorrow, since those prices would not be subject to continuous administrative supervision and readjustment in light of changed conditions. Those who controlled the prices would control or effectively dominate the market. And those who were in that strategic position would have it in their power to destroy or drastically impair the competitive system. But the thrust of the rule is deeper and reaches more than monopoly power. Any combination which tampers with price structures is engaged in an un-

lawful activity. Even though the members of the price-fixing group were in no position to control the market, to the extent that they raised, lowered, or stabilized prices they would be directly interfering with the free play of market forces. The Act places all such schemes beyond the pale and protects that vital part of our economy against any degree of interference. Congress has not left with us the determination of whether or not particular price-fixing schemes are wise or unwise, healthy or destructive. It has not permitted the age-old cry of ruinous competition and competitive evils to be a defense to price-fixing conspiracies. It has no more allowed genuine or fancied competitive abuses as a legal justification for such schemes than it has the good intentions of the members of the combination. If such a shift is to be made, it must be done by the Congress. Certainly Congress has not left us with any such choice. Nor has the Act created or authorized the creation of any special exception in favor of the oil industry. Whatever may be its peculiar problems and characteristics, the Sherman Act, so far as price-fixing agreements are concerned, establishes one uniform rule applicable to all industries alike.

Moreover, it was held that proof of actual success in price raising was not essential to conviction of the defendants. The charge of conspiracy to restrain trade could be sustained simply by evidence that the combination had desired and intended to raise prices. The Court differentiated between Sections one and two of the Sherman Act, holding that mere *purpose* to restrain trade constitutes an illegal conspiracy under Section one, whereas under Section two the existence or exertion of *power* to monopolize trade must be shown as well. The companies' claim of immunity because of official acquiescence in the buying plan was dismissed by the Court as unproven and, in any case, irrelevant.

The *Madison Oil* decision thus appeared to restore the Sherman Act's unequivocal condemnation of loose agreements directed toward market control. Antitrust law enforcement, however, was still faced with the difficult task of showing in particular cases that the methods employed by an association are, in fact, intended to influence prices or production. That this is no light burden is well demonstrated by the *Sugar Institute* case of 1936.

3. The Sugar Institute—A Case Study

By virtue of its recent date, the importance of the industry, the range of association activities, and the masterly analysis by Judge Mack in his fifty-five-thousand-word opinion for the district court,

the *Sugar Institute* case [35] affords an outstanding case study in the intricate factual situations which are encountered in the application of antitrust policy. During the decade before the first World War, the once near monopoly of the Sugar Trust had slowly lost its grip on the refining industry. The development of new refining capacity, stimulated largely by the Trust's success, soon threatened repetition of the competitive conditions which led to the original combination. The industry was rigidly controlled during our participation in the war, but government regulation was abandoned in 1919. In 1927, when the Institute was formed, there were fifteen companies refining imported raw sugar. These companies supplied about four fifths of the total amount consumed. Domestic beet sugar, Louisiana cane, and cane refined abroad accounted for the remainder. No single refiner now dominated the industry. The American Company's proportion had fallen from 98 to 25 per cent. It was closely followed by National, with 22 per cent, while the others ranged from 1 to 7 per cent. Overcapacity had led to widespread secret price concessions and rebates, other unfair competitive practices, and severe reduction in profits. The year 1927 was particularly unfavorable, for these disrupting factors were augmented by the fashionable campaign to achieve slimness of figure.

Under the stimulus of these conditions, the refiners met together and evolved a plan for a trade association. A Code of Ethics was drawn up and submitted to the Department of Justice for suggestions. The Institute's files were opened to the Department from 1928 through 1930, shortly before the suit was filed. It is important to note, however, that the Department was not notified of all the measures taken by the Institute. The case is an admirable illustration of the dangers of advance approval of proposed co-operative activities by the prosecuting agency. The actual effect of complex agreements among competitors is not always predictable, and it is in any event impossible for an Attorney General to bind his successors without the sanction of a judicial decision.

The hopes of the Institute members centered about the rules laid down in the Code of Ethics. That they expected much from its operations is indicated by the $75,000 salary paid to the executive secretary. The primary purpose was ostensibly the abolition of price discrimination among customers. To this end, members agreed to

[35] *United States* v. *Sugar Institute, Inc.*, 15 F. Supp. 817 (1934); *Sugar Institute, Inc.* v. *United States*, 297 U.S. 553 (1936).

sell only upon open prices and terms, and changes were to be announced at least one day in advance. Prior to the Institute, individual members had announced future price changes as part of the industry's custom of selling on "moves." A "move" occurred when a price advance was announced, the buyers taking large orders in the period of grace before the actual change. There was no fixed time period allowed, however, and there was, of course, no obligation to adhere to the announced prices. In fact, departures from them had been very frequent.

The Institute also compiled and disseminated to members statistics on production, sales, shipments, and inventories. Unlike the Maple Flooring association, it did not make them available to buyers. This practice was judged by the trial court to place the refiners in an "advantageous position" in their market dealings.

The most striking feature of the Institute was the extraordinary variety of conditions laid down as to terms of sale and methods of distribution. It was argued in defense of these requirements that they were all essential to the prevention of secret price concessions. Members were forbidden to deal with anyone combining the functions of broker, warehouseman, and merchant, or any two of them. Concerns previously combining such functions were arbitrarily forced to select one, and one alone, for the future. Brokers' commissions were fixed by agreement. In consequence of Institute discussions, although not through explicit agreement, members developed a basing-point system, concertedly maintained by refusals to sell f.o.b. refinery. Delivered prices were based on all-rail freight rates, buyers thereby being prevented from availing themselves of the slower, but cheaper, means of transportation by water. Miscellaneous minor transportation terms were also fixed by agreement, regardless of the differing circumstances or requirements of purchasers. The Institute reduced the number of consignment points for bulk sugar, to the serious disadvantage of many communities. The terms of contracts for sale were narrowly circumscribed. They could not call for deliveries over a period longer than thirty days. Quantity discounts were forbidden, despite savings in cost attributable to quantity sales. Credit terms were rigidly standardized. Guaranties to purchasers against price declines were forbidden. Packing sugar for sale under merchants' private brands was discouraged. Allowances to customers for the return of used bags were forbidden. Sales of secondhand sugar, damaged stocks, and "frozen"

stocks were all limited by Institute action. In short, every possibility of special concession was eliminated, and every element of the price structure was concertedly regulated and maintained, except for the basis price itself. And the basis price was subject to the requirement of advance announcement. The government alleged that there was concerted price fixing by direct agreement as well, but this contention was rejected by the trial court.

When the industry's economic position before and after the establishment of the Institute was analyzed, certain sharp contrasts were brought to light. The ratio between the number of price changes for refined sugar and that for raw sugar dropped markedly. The margin between the prices of raw and refined sugar, and in consequence the refiners' profits, also increased substantially, since refined sugar prices were maintained in the face of sharp declines in the raw market. These contrasts were largely due, according to Judge Mack, to Institute activities: the one-sided dissemination of statistical information, the uniformity of the price structure, "the stabilizing effects of the friendly, co-operative spirit the Institute brought to the industry," and the advance announcement of changes in basis price. The effect of the uniform price structure was held

> to eliminate the possibilities of price variations to distributors or ultimate purchasers at any given time with the opportunity by underselling to disturb the price structure; refiners were thereby relieved, too, of the pressure to reduce prices that would otherwise have been exerted upon them by those who could not or did not get the lower prices or better terms.

The trial court expressed this judgment on the requirement of advance announcements:

> The assurance which the open-price system under the Institute gave to each refiner [was] that the only prices and terms he need meet were those openly announced in advance of sales by his competitors. . . . Each refiner is encouraged to maintain or raise prices by the assurance that until public notice is given, his competitors will not lower their announced prices; and even if they believed that market conditions warranted a decline, the tendency would be to defer it until "the traffic would no longer bear" the then prevailing price.

On the facts, Judge Mack concluded that "a direct basis price agreement was not vital to defendants' purpose; in part, at least,

they were able to maintain prices through preserving the price structure, withholding statistics from the trade and effectuating the open-price scheme." Under these conditions, he felt, the Sherman Act had clearly been violated. Restrictions on the various elements of the price structure had gone far beyond the extent required for the elimination of abuses; the effect of the restrictions was to eliminate competition in terms of sale, transportation, and distribution, and to prevent experimentation in more economical distributive techniques. The withholding of statistics from the purchasing trade was directly condemned. The open-price system itself, when applied to future prices, was judged to "aid both in maintaining price levels without regard to the normal effect of supply and demand and in eliminating, ofttimes, entirely fair competition." The ostensible purpose of preventing discrimination and secret concessions could have been attained through publication of details of past transactions alone. The trial court's decree, while not dissolving the Institute, enjoined the continuation of its central activities, including the open-price system. The court also forbade dissemination of statistics not supplied to purchasers, and all the devices for standardizing terms of sale and methods of transportation and distribution.

The Supreme Court, without dissent, sustained this view of the law and affirmed the decree with only minor modifications. The Sherman Act, it said, does "not prevent the adoption of reasonable means to protect interstate commerce from destructive or injurious practices and to promote competition on a sound basis." But there are limits. "The endeavor to put a stop to illicit practices must not itself become illicit. As the statute draws the line at unreasonable restraints, a co-operative endeavor which transgresses that line cannot justify itself by pointing to evils afflicting the industry or to a laudable purpose to remove them." Stress was laid on the high proportion of the sugar market supplied by Institute members, in contrast with the situation in the *Appalachian Coals* case. Here "the maintenance of fair competition between the defendants themselves in the sale of domestic refined sugar is manifestly of serious public concern." Since sugar is a standardized commodity of uniform quality, and competition must therefore be largely on the basis of price, it is "the more important that such opportunities as may exist for fair competition should not be impaired." The principal alteration in the decree, as modified by the Supreme Court,

eliminated the prohibition of advance announcement of price changes, which the Court felt justified by the trade custom of selling sugar on "moves." Instead, the Court prohibited the requirement of *adherence* to the prices and terms thus announced in advance. This modification was of little value to the Institute. Shortly afterwards it was voluntarily dissolved.

While the activities of the Sugar Institute were somewhat more than ordinarily complex, the case is a fair sample of the difficulties of antitrust regulation under the rule of reason. If co-operative action is to be permitted to eliminate abuses and promote "fair competition," some supervision is essential lest co-operation be abused. In this instance the Department of Justice had to build up its record in an investigation lasting several years; the evidence taken in court covered over ten thousand pages, besides nine hundred exhibits; and the trial judge required ninety large, double-column pages to analyze the facts and the applicable law. The cost to the government ran into the hundreds of thousands of dollars. The case was heard before an unusually competent judge, skilled in analysis of economic matters. Not all federal judges are so qualified. Nor does the condition of our district court calendars often permit so large an expenditure of time on a single case. After the conclusion of a suit and the issuance of a decree, the court may have to retain jurisdiction and hear numerous applications for modification of the decree.

The efficacy of judicial regulation under these conditions is, of necessity, very limited. If antitrust policy is to be maintained at all, and co-operative activity of any sort to be permitted, the situation would appear to call for continuing administrative supervision, and perhaps participation in meetings, of both associations and dominant corporations which have the power to affect market conditions. In one aspect, the National Recovery Administration was such an experiment. Before considering the NIRA, however, we shall examine briefly the policy of leading foreign nations toward the growth of business combinations within their borders.

4. Trade Associations and Cartels Abroad

In the leading industrial countries of Europe, trade regulation policy has followed a course in striking contrast to the American antitrust laws. Reasons for the differences in attitude vary, but cer-

tain basic factors, lacking to the United States, have operated uniformly in Europe. Foreign trade has played a far more important role for Europeans than for Americans, since American industries are favored with a continent-wide domestic market. In some cases, co-operative organization of the domestic industry has appeared to European nations a necessary prerequisite to effective competition with outsiders. Such organization has been not merely permitted, but even fostered, by the respective governments. Until 1932, consumer interests were protected in large part in England by the policy of free trade, which offered Continental competition as a restraint on excessive domestic prices. Agrarian populism, the core of political support for our antitrust policy, has no precise counterpart abroad. The teachings of the historical school of economists, finally, which were more widely accepted on the Continent than those of the classical Manchester school, favored a more lenient attitude toward the organization of business as capitalism reached its "maturity."

GREAT BRITAIN

Until the enactment of the Sherman Act in 1890, the United States and Great Britain based their trade regulation policy on identical common-law doctrines. At the very time when the American states and the federal government were led to supplement the common law by legislation, however, British courts began to veer away from condemnation of market controls. The law's prohibition of contracts in restraint of trade was progressively relaxed by a rule of reason invariably stressing freedom of contract and the right of entrepreneurs to defend their economic position. Thus, the British courts sustained resale price maintenance, tying contracts, and other competitive methods forbidden in America. A similar attitude developed toward combinations in restraint of trade, whether organized in trade associations or otherwise. Agreements restraining competition must still be reasonable as among the participants themselves, and, in theory, must not violate the public interest. So attenuated is the latter criterion, however, that output restriction, price fixing, and division of market territory have all been upheld. Mergers are not questioned by the law. General legal restrictions on business co-operation, therefore, are virtually nonexistent.

Nonetheless, pre-World War I British industry was relatively free from either large combines or cartel arrangements. Britain's

good fortune in having a head start of two generations in the Industrial Revolution had established her during the middle nineteenth century as the world's leading manufacturer. Under these conditions there was little positive pressure for combination, while weighed in the balance against it was the strongly individualistic tradition of small and middle-sized family concerns in the Midlands, Yorkshire, and Lancashire. Outstanding corporate combinations appeared around 1900 in salt, cement, whiskey, tobacco, soap, matches, and wallpaper. Loose associations were formed, from time to time, in branches of the textile and iron and steel industries, but they proved to be short lived. In the great majority of instances, duty-free foreign competition sufficed to prevent the abuse of such monopolistic power as existed. The effects of economic mobilization during World War I and the severely depressed postwar condition of the leading export industries completely altered the industrial outlook. Large fractions of Britain's staple export market seemed permanently lost, either through technological change or through American, German, or Japanese competition. Tariff barriers were erected in the British Dominions and the smaller European nations in order to stimulate domestic industry. With the loss of former markets, the British textiles, coal, and iron and steel industries entered a phase of stringent contraction, paralleled to a lesser degree in other fields.

Meanwhile, the organization of trade associations had been so greatly extended during the war as to call for public investigation. A Committee on Trusts, reporting in 1919, was "satisfied that Trade Associations and Combines are rapidly increasing in this country, and may within no distant period exercise a paramount control over all important branches of the British trade." [36] The Committee suggested no positive governmental policy beyond establishment of a standing committee of investigation under the Board of Trade. A concurring report, signed among others by J. A. Hobson and Sidney Webb (now Lord Passfield), was more concerned about the effect on consumers of private market control. However, these members unhesitatingly rejected the possibility of adopting an antitrust policy. In their opinion, such a policy was unenforceable. Moreover, in their words: "We have to recognize that association and combination in production and distribution are

[36] Ministry of Reconstruction, *Report of the Committee on Trusts,* Cd. 9236 of 1919, p. 11.

steps in the greater efficiency, the increased economy, and the better organization of industry," and are "both inevitable and desirable." The far-reaching proposals of this concurring minority for regularized price control and partial public ownership received no consideration from the government. Similar suggestions were again rejected by the Balfour Committee on Industry and Trade, which reported in 1929.[37] The Committee advised strongly against "the enactment of any such measures for the suppression of combination as have been attempted, with very doubtful success, during the past forty years by the antitrust laws of the United States."

As markets continued to slip away during the nineteen-twenties, leaders of both politics and industry turned to co-operation, consolidation, and "rationalization" as remedies. Rationalization may be defined as encouragement or even coercion of amalgamation, cartelization, and technical reconstruction in the interests of improved productive and commercial efficiency, with concentration of output in the most efficient plants of the industry. New light industries arose from the start under the control of a few closely associated firms. Government policy turned gradually from verbal encouragement of industrial "self-government" to encouragement by deeds. An act of 1930 subjected the coal-mining industry to compulsory cartelization, with minimum prices and production quotas to be allocated by regional sales agencies. Provisions for compulsory amalgamation were also included, but in a weak and ineffective manner, only slightly improved by amendment in 1938.

The peak of the new policy, however, was reached only after the introduction of a far-reaching protective tariff in 1932. Under the guidance of an administrative tariff-making organ, the Import Duties Advisory Committee, a number of industries were compelled to eliminate domestic competition and to centralize the formation of their price and output policies. Thus, iron and steel are now controlled by the watertight British Iron and Steel Federation. Shipbuilding subsidies were also conditioned upon cartelization and partial amalgamation, with arrangements for the scrapping of obsolete tonnage. Various sections of the textile industries were organized under statutes giving majorities power to bind minorities, to destroy "redundant" capacity, to allocate output, and to fix minimum prices. Agricultural Marketing Boards representing producers

[37] Cmd. 3282 of 1929, p. 176.

were set up under Parliamentary authority for milk, hops, potatoes, pigs, and bacon. In other areas, like electrical industries, cement, and potteries, full-fledged cartels have developed without the need of statutory encouragement. The decade since the start of the Great Depression thus witnessed widespread alterations in Britain's industrial and commercial structure, quite apart from the further changes imposed by the second World War.

In the face of these developments, successive British governments evolved no co-ordinated policy of control, and little machinery to prevent abuse of monopolistic power. Each industry's problems were taken up as short-run pressures demanded. Conservative governments, in office after 1931, conceded measures which permitted price and output controls, without insisting upon parallel measures to ensure the improved efficiency through reorganization which was held out as justification for the policy. The Labour Party, while often criticizing details, saw in cartelization a step toward possible nationalization, and was therefore loath to combat the movement. Only a scattering of isolated voices protested the virtual abandonment of price competition as the basic regulator of economic activities.

British developments have occurred too recently and under too abnormal conditions to afford a model of value, either positive or negative, to American public policy. The major industries subjected to compulsory organization were so treated in a desperate effort to recover shrinking foreign markets. In the boom based on armament expenditures which preceded the second World War, the government exercised considerable influence on price policies through its bargaining power as a large purchaser. Up to the present, however, no administrative technique or policy has been devised to ensure some measure of flexibility and economic progress when expansion is to be based on ordinary civilian demands in peacetime. The chief lesson of British prewar experience is a demonstration that under a regime of cartelization some such techniques are necessary.

FRANCE

France's economic system underwent a complete transformation after the Revolution of 1789. The new order was based upon a government policy abolishing guild restrictions and promoting freedom of trade. The Loi de Chapelier of 1791 forbade all types of economic association whatsoever. It was followed in 1810 by Sec-

tion 419 of the Penal Code, which provided penalties for concerted action by the dominant members of a trade to fix prices or to raise or lower them "above or below the price which the natural and free course of competition would determine." This provision remained in force until 1926. A Civil Code provision upholding "freedom of commerce" was construed to apply the same criteria. Until the end of the nineteenth century, judicial interpretation was quite hostile to combinations, stressing the desirability of protecting consumers from price exploitation.

The bulk of French industry at this time was not well suited to trustification or even cartelization. It did not require heavy capital investment; it concentrated on finishing trades; and it emphasized quality rather than mass production. Loose trade associations, however, began to develop after 1850. They were legalized by the repeal of Chapelier's Law in 1884. As industrialization progressed, moreover, and particularly in the face of German competition, experiments were made in organizing common sales agencies and allocating output through "comptoirs." These organizations had all the basic characteristics of cartels, but were more loosely integrated than their German counterparts. A marked liberalization of judicial attitude after 1890 sustained their operations, except in extreme cases of abuse of power. Stress was now laid by the courts on the dangers of cutthroat competition and competitive wastes. The criterion of illegality became excessive profits, determined after investigation of costs and price changes. Thus, the groundwork was laid for recognition of full-fledged cartels in the heavy industries of Alsace and Lorraine, taken over from Germany at Versailles. The 1926 amendment to the Penal Code recognized the change by establishing a criterion of abnormal profits in place of abnormal prices. French law thus became only slightly less lenient than British in allowing concerted market controls.

Competition with rationalized German industry during the late twenties and the economic depression of the thirties greatly accelerated the process of voluntary cartelization. Agreements were made in some instances with foreign competitors as well as domestic firms, thus setting up international cartels. Following the British example, the government undertook after 1935 a policy of active promotion, including compulsory cartelization in rayon, coal, and especially the auxiliary war supply industries. Governmental influence over price and output policy was exerted through direct par-

ticipation in the cartels and in some instances through administrative price fixing. In the years immediately preceding the second World War, French governments were granted general powers to fix prices by decree, in order to check the effects of the armament boom and the instability of the currency. Thus, cartel policies were subjected to increasingly close public supervision.

GERMANY

Lacking the legal traditions both of the common law and of the French Revolution, German public policy toward industrial combinations during the nineteenth century was one of complete laissez faire, making no effort to interfere with private economic activity. Attempts around 1890 to apply to such combinations the general provisions of the Civil Code which forbade injurious acts and agreements *contra bonos mores* proved unavailing. Judicial opinion of the time looked with sympathy on producers' cooperation to prevent price cutting, feeling it to be not only in the legitimate interest of producers, but in the general interest as well. Germany consequently became the leading laboratory for experimentation in cartel agreements and a fertile field for industrial mergers as well.

German cartelization received its first major impetus in the industrial depression of 1872–86. Heavy industries, including branches of iron and steel, coal, and potash (of which Germany had a monopoly), took the lead, followed toward the end of the century by chemicals, cement, and glass. The prosperous decade which followed witnessed a great wave of consolidation. The imperial government's attitude toward both cartelization and consolidation was sympathetic. Considerations of domestic policy were subordinated to the objective of making Germany a great world power. The nation's primary economic task was seen as the organization of an industrial system capable of winning foreign markets from England and the United States. With domestic competition eliminated, German businessmen might concentrate their efforts on this national aim. Abuse of domestic monopoly power was hindered partly through a very stringent incorporation law, and partly through the contingent threat of adverse action by an authoritarian government secure in its power. In keeping with this attitude, compulsory cartelization with minimum export prices was applied to the potash industry in 1910, to prevent low-price sales to American consumers

by a few American-controlled mines. Administration of the potash syndicate was vested in a board composed mostly of mineowners, but including three representatives of the government.

Wartime industrial mobilization after 1914 was carried through more quickly in Germany than in any other combatant nation. Compulsory cartelization under direct government control was a leading feature of the program. The Weimar Constitution of 1919, written by a coalition in which Social Democrats predominated, did not establish a socialist economic order, but it was intended to provide a basis for rapid socialization and transition to a planned economy. The government proposed to organize each large industry under a central government corporation, with the entire economy co-ordinated by an "economic parliament." Preliminary socialization laws were passed in 1919 for the potash, coal, and electricity industries, but a conservative political reaction prevented actual nationalization. For these industries, compulsory cartelization was continued under public supervision through councils representing labor, consumers, government, and employers, but with the latter predominant. The position of these industries became analogous to that of American public utilities. The socialization movement proper was dead by 1921.

Ensuing currency instability brought forth a wave of voluntary cartelization on a new basis. Businessmen in all fields sought by co-operative agreement with competitors to force onto their consumers the risks of inflation. The new cartels, therefore, were more concerned with uniform terms of sale than with control of the market. Borrowing was made so profitable by steady inflation that the objective of market control was sought rather through promotion of gigantic corporate consolidations and holding companies, led by the activities of Hugo Stinnes and by the chemical trust *I.G. Farbenindustrie*. The new cartel policy, however, while milder in its long-run effects than that of the pre-World War I movement, ran directly counter to the immediate interests of the politically influential consumers' co-operatives, which demanded public regulation. The government responded with an "Ordinance Against the Abuse of Economic Power," generally known as the Cartel Law, in 1923. With a minor amendment in 1930, this law was the only generally applicable regulatory statute enacted before the advent of National Socialism in 1933.

The measure as adopted was very mild. Opponents of the cartels had sought to compel their registration and to require publicity for all their affairs, coupled with close regulation by the government on the advice of consumer representatives who would sit on cartel boards. In fact, neither registration nor consumer participation was conceded. The law set up a specialized, quasi-judicial administrative court of five members, the *Kartelgericht* (Cartel Court). The personnel included judicially trained members, representatives of the individual interests concerned in particular cases, and an independent economic expert. Cartel agreements affecting production, sales, prices, and terms were required to be in written form, in order to avoid the ambiguities of verbal agreements. If any such agreement was thought to be "injurious to the national economy or the public interest," the Minister of Economic Affairs might apply to the Cartel Court for an order either (1) nullifying the agreement, (2) permitting separate members to withdraw from its obligations, or (3) directing its transmission to the Minister before permitting its enforcement. The general criterion of "public interest" was declared to include "economically unjustifiable" price fixing or restriction of output, unjust discrimination, and excessively restrictive boycotts. Individual members of a cartel were also permitted to withdraw without previous notice for "just cause," including the "inequitable restriction" of their economic freedom, subject to appeal by the cartel to the Court. Internal disciplinary measures were also subjected to administrative sanction of the Court's President, with appeal to the full Court. The final substantive section, applicable to trusts as well as cartels, warrants quotation in full:

> Should the conditions of trading or the methods of price fixing employed by any undertaking or combination or amalgamation of undertakings . . . appear likely to endanger the national economy or the public interest through the exploitation of economic power . . . then the Cartel Court on the proposal of the Reich Minister of Economic Affairs may issue a general declaration permitting all injured parties to all contracts of the category referred to above to terminate their contracts without notice.

With few exceptions, litigation before the Cartel Court was limited to the section permitting members to withdraw without

notice. The case law built up around this provision sanctioned such withdrawal only in extreme instances, where a decline in the cartel's position in the industry or a radical shift in the internal balance of power threatened a member with virtual extinction. The more general provisions depended for their effectiveness upon the threat of action by the Minister of Economic Affairs; such threats generally sufficed to achieve the desired results. No criteria were developed, therefore, for a definition of "economically unjustified" price or output regulations. The system was accepted on all hands, during the twenties, as reasonably satisfactory, although proponents and opponents of the cartel movement continued to dispute over details. The report of the Commission of Inquiry into the Conditions of Production and Marketing in Germany, published in 1931, recommended little change beyond a system of appeals from Cartel Court decisions to the ordinary higher tribunals.

Yet the solution thus evolved in Germany did not penetrate to the fundamental issues of trade regulation policy. Granted the acceptance of widespread cartelization, the public machinery of supervision proved adequate as a means of regulating intraindustry disputes and gross abuses of monopoly power. It did not touch the underlying questions of economic dislocation, including excessive protection to inefficient cartel members, misdirection of investment, and possible obstacles to technological progress. For solution of these issues, which are paramount in America today, the German experience offers little aid. The crisis of the German economy after the withdrawal of foreign loans in 1929 was attacked by far more radical measures, first in the deflationary era of 1930–32 and later under the National Socialist regime. These measures included widespread, direct price fixing by the government and the extension of compulsory cartelization to almost every important industry. Voluntary industrial organizations were thus converted into mechanisms for the imposition and administration of totalitarian controls.

THE LESSONS OF FOREIGN EXPERIENCE

The trade regulation policy of none of the large industrialized nations, with economies comparable in complexity with that of the United States, seems so marked with success as to provide a clearly desirable standard for this country to imitate. Nor has it been common for American reformers in this field to search abroad for

models. Yet some generalizations stand out which appear relevant for America. Absence of a militant antitrust policy anywhere else is one. Another is the uniformly noticeable pressure toward business co-operation and mitigation of competition whenever an industrialized nation has been faced with economic depression. It may be seriously questioned whether under conditions of monopolistic competition, and especially where industries have high fixed costs, competitive price and output fixing can be preserved by any system of legal and administrative prohibition. Whatever its abstract economic merits, political pressure for generalized price stabilization appears almost irresistible.

At the same time, no government which has accepted combinations and cartels has been able to leave them untouched. While no stable or universally acceptable control mechanisms have been devised, the more effective controls have always depended on expert administrative agencies with considerable discretion, rather than legal process in the ordinary courts. And, in most instances, the Great Depression has led governments into direct participation in the formation of commercial policy in the major cartelized industries.

5. The Movement for Antitrust Law Reform

The United States provided no exception to the general trend against unlimited competition in the post-World War I era. A new and widespread merger movement arose, released from legal obstructions by the rule of reason. Trade associations flourished. Above all, the business scene was characterized by a changed attitude toward competition. The catchwords of Eddy's plea for "constructive co-operation" were ubiquitously circulated. Competition in style, quality, services, selling methods, and advertising appeal was enhanced, but *price* competition came to be feared and despised as "chiseling." Although price agreements were taboo, as we have seen, the officers of trade associations and other co-operative institutions never ceased to preach the sins of price cutting, and individual businessmen were not slow to draw the moral voluntarily. Nor did government agencies, except for sporadic acts of the Department of Justice, look askance at this development. "Opposition to 'price cutting,'" reported the FTC in 1929, "is very frequently voiced by trade association representatives. Such opposition has its good aspects. It is unfortunate that competition is so largely

a matter of prices, rather than of quality and service. A shift in emphasis is desirable." [38]

During the prosperous years of the twenties, this attitude could often be translated into business practice without reference to the antitrust laws. Where size and position of a particular firm gave it prominence in an industry, its leadership in price making might be followed by others without illegal collusion of any sort. Such price leadership, frequently commented on in the steel, gasoline, and agricultural machinery industries, became a common feature of the American economy. So evident were the dangers of a price war, and so powerful the new business psychology, that voluntary price stabilization was the rule rather than the exception for a decade after the first World War. Against this harmonious picture, two major industries stood out in glaring discordance. Bituminous coal and cotton textiles, where excess capacity had led to bitter competition in prices, and even more severe competitive reduction of labor standards, were singled out in the public mind as typical "sick" industries.

In inverse proportion to the effectiveness of their voluntary cooperation, businessmen demanded legal sanction to achieve the universally desired price stabilization. The "sick" industries took the lead. But, with the coming of general depression after 1929, sickness became contagious. Tacitly accepted schemes of price stabilization, effective enough in the face of continuously rising demand, quickly collapsed as individual businessmen sought to save their own markets and to stave off approaching ruin. Fear of loss was now close to panic, and mere name calling would not prevent price cutting. Hence arose a swelling movement for legalization of voluntary agreements for market stabilization, and even for forcing adherence by unwilling minorities to a majority-formulated commercial policy for the industry.

This attitude was typified by an address of the counsel of the Cotton Textile Institute in 1931.[39] His industry suffered from severe overproduction (defined in terms of a supply salable only at prices below cost). Its problems could only be solved, the counsel thought, by permission to "balance production with demand,"

[38] FTC, *Open Price Trade Associations* (1929), p. 295.

[39] W. D. Hines, "The Antitrust Act of 1890 and Trade Associations," in M. Handler, *The Federal Antitrust Laws: A Symposium* (1932), pp. 75–90.

through co-operative allocation of production quotas. Demand was to be "arrived at and tested by statistics which have been in existence for a considerable number of years." In his mind there was "an essential difference between curtailment of production in order to create a shortage and a curtailment of production in order to avoid an overproduction." When "demand rises," production was to be adjusted accordingly. Such an experiment, in his opinion, might be permitted by executive co-operation in antitrust law administration or, if necessary, by legislative amendment. An elastic arrangement of this type appeared to him clearly in the public interest.

Such proposals were utterly irreconcilable with the Sherman Act as then interpreted. But they represented a force which could not be suppressed. That their terms were shot through with ambiguities, that "demand" was viewed as fixed regardless of price, that quota allotments failed to discriminate between efficient and inefficient plants, that such schemes might delay indefinitely the migration of capital out of the industry, and that the suggested control powers might be abused—all these considerations were, for the moment, politically irrelevant. The assumptions underlying antitrust policy had, in fact, been abandoned. As depression deepened, organized labor saw in "stabilization" some hope of wage maintenance and joined its forces to the rising tide of antitrust reform.

Specific suggestions for revision of the law ranged from relatively mild amendment to outright repeal. Advance executive approval, by either the FTC or the Department of Justice, was most commonly suggested, with the tacit assumption that these bodies would approve a degree of "reasonable" co-operation then forbidden. Advance approval would confer absolute exemption from prosecution in public or private suit. It would thus go far beyond the informal expressions of opinion offered by Attorneys General since 1921, which had been of no legal effect. Alternatively, it was proposed to permit co-operation within the bounds of "reasonable" prices and profits, with abuses still subject to correction in the courts. The phrase "economic planning," formerly the monopoly of a handful of socialists, became a national catchword. In the autumn of 1931, Gerard Swope, president of the General Electric Company, presented a plan for nation-wide "co-ordination of production and consumption" through legalized co-operative stabilization of competitive methods and prices. He was followed by a United States

Chamber of Commerce report favoring antitrust law revision to permit similar stabilization devices, under the guidance of a National Economic Council.

Congress and President Hoover were too busied with alternative attacks on the depression to give attention to antitrust law reform. Legislation had to await the coming of the newly elected Roosevelt Administration in 1933. By then, depression had become crisis. With unemployment at 13,000,000 or more, personal, industrial, and financial bankruptcy rampant, and even talk of violent action among powerful groups of the community, many businessmen were losing confidence in the entire economic order as they had known it. The strands of policy woven into the National Industrial Recovery Act far transcended the field of mere trade regulation. But one major strand was the response to business demands for a maximum of self-regulation free from the restraints of traditional antitrust policy. Seen in retrospect, that brief but gigantic experiment in economic reorganization had its greatest significance as an approach toward cartelization for the entire American industrial economy.

Chapter Sixteen. THE NATIONAL INDUSTRIAL RECOVERY ACT AND BEYOND

The National Industrial Recovery Act of 1933 was the first substantive legislative modification of American antitrust policy. It was described by President Roosevelt, when he signed it, as "the most important and far-reaching legislation ever enacted by the American Congress." It linked together the development of trade association policy and the regulation of competitive methods, by turning over to the associations themselves a large share of responsibility for redefining unfair competition. It permitted them a latitude far beyond any previous conception of "unfair methods of competition." It was, essentially, an experiment in industrial self-government, subject to a mild degree of governmental supervision and to more important limitations in the form of minimum labor standards and protection for labor self-organization, exacted in return for the new liberty of association.

Yet the immediate occasion of the NIRA was not merely pressure for reform matured after long consideration. It was the child of crisis, of the near-panic conditions in the spring of 1933. If objectives of short-run recovery and long-run reform were blended in its terms, emphasis was heavily weighted on the side of the former. The Act was viewed as an emergency measure; it was limited to two years' duration; and its constitutional justification was supposed to rest largely in the state of emergency. Its first title, which alone directly concerns us here, was intimately associated with the $3,300,000,000 public works program of Title II. Its administration was hampered

by the haste and confusion of emergency. The stress on immediate action, rather than on previsioned choices of policy, contributed to the administrative chaos which hastened the experiment's decay in 1935, months before the Supreme Court declared it unconstitutional.

1. The Background of the NIRA

On May 17, 1933, a National Industrial Recovery Bill was sent from the White House to Congress, accompanied by a brief message from President Roosevelt. He requested machinery for "a great co-operative movement throughout all industry in order to obtain wide re-employment, to shorten the working week, to pay a decent wage for the shorter week, and to prevent unfair competition and disastrous overproduction." The measure provided for establishment of "codes of fair competition" by industrial groups or associations, to be approved by the President through a new agency constituted at his discretion. Before approval, he would have to find that the associations were "truly representative," that the proposed codes were "not designed to promote monopolies, or to eliminate or oppress small entrepreneurs," and that the codes tended "to effectuate the policy" of the Act. He might modify code provisions in order to protect consumers, competitors, employees, or the public interest. Violations were to be punishable by fine, and also subject to Federal Trade Commission cease and desist orders, regardless of whether the firm concerned had participated in formulation of the code. If an industry failed to submit a code of its own accord, the President might impose one after notice and hearing. In extreme cases, he might subject an industry to a licensing requirement, no unlicensed person being permitted to operate in the prescribed field. The President might also enter into or approve voluntary agreements among industrialists, or labor organizations, or both.

Codes, licensing requirements, and agreements were all to be exempted from the antitrust laws for the two-year duration of the Act. Every code and agreement was to contain terms guaranteeing to employees "the right to organize and bargain collectively through representatives of their own choosing" and outlawing "yellow-dog" contracts. Codes would also set forth wages, hours, and working conditions prescribed or approved by the President. Maximum hours and minimum wages were to be fixed by collective bargaining whereever possible, but otherwise prescribed by the President at his own

discretion. All code provisions were to be subject to cancellation or modification at any time, again at the President's discretion. Title II of the bill provided for a comprehensive public works program, carrying an appropriation of $3,300,000,000, and including blank sections to be filled in with tax proposals designed to cover interest and sinking-fund charges on this sum.

The bill thus placed in the hopper of the hectically busy "Hundred Days" special session of the Seventy-third Congress was compounded of diverse elements, each with its own substantial history and each designed to elicit support from one of the great organized political forces of the nation. The basic elements were three. First came relaxation of the antitrust laws and permission to industrialists to eliminate competitive practices and even competition itself when they felt it desirable. The new rules would be bulwarked by compulsion on recalcitrant minorities and, in extreme cases, on entire industries. Labor provisions, secondly, were of two kinds: establishment of floors under wage and hour standards in each industry, and protection of independent union organization. The public works program, finally, was designed as an impetus to immediate reemployment and recovery.

Behind the relaxation of antitrust policy lay the movement described in the last chapter. It had the support of a number of businessmen who had for decades urged the recasting of the American industrial order into a framework of what they termed "constructive co-operation." But the overwhelming pressure behind it was occasioned directly by the depression. A substantial group of small businessmen attributed their troubles primarily to competitors' sales below cost, now to be eliminated by code. Larger business, speaking through the United States Chamber of Commerce and the National Association of Manufacturers, saw an opportunity for profit "stabilization." The earliest drafts of the recovery bill contained merely the provisions for codification, licensing, and suspension of the antitrust laws; these were the core of the measure as finally enacted.

Although the new conception of "unfair competition" was undefined, and might presumably include any practices disfavored by the majority of an industry's members, it was generally agreed to include labor "sweating." The precise point at which increased hours, lowered wages, and deteriorated working conditions became "sweating" again went unspecified, but it was understood from the start that each code would contain some minimum degree of protection for labor

standards. This aspect of the bill was closest to the heart of Senator Wagner of New York, who played a central role in shaping its form and carrying it through Congress. Active support from organized labor, however, required more substantial advantages than this. The full weight of the American Federation of Labor had been thrown, earlier in the session, behind the movement for a compulsory thirty-hour week, designed to reduce unemployment by "sharing the work." Work spreading had also been urged in principle by the Chamber of Commerce, but subject to a reservation deprecating fixed statutory standards applying uniformly to all industry. Early in April, 1933, the Senate approved the Black-Connery thirty-hour week bill by a large majority. This measure went well beyond the point accepted by the business community. Its rigid terms were strongly disapproved by the Administration as well, but it was prevented from coming to a vote in the House only by a promise to achieve similar results through the forthcoming general industrial recovery legislation. In the eyes of labor leaders, however, the prize provision of the bill was Section seven, which guaranteed the right of organization in independent unions. If they could once secure organization, they felt, labor would be assured of a substantial proportion of industry's gains from cartelization.

Thus, the measure had the blessings of both organized business and organized labor. Throughout its texture, finally, ran evidences of widespread public support for some form of "economic planning," and of a response to the then most popular single theory of the depression's causes. If consumers' demand could only be increased by a revival of "purchasing power" among the masses of the population, it was thought, the deflationary spiral would be reversed. With competition relaxed, the pressure of organized labor would force a greater share of the national income into the hands of workingmen. Public works were to take up some of the immediate slack and "prime the pump" for a regenerative process which would later become self-operating.

In its rapid passage through the House of Representatives, the bill clearly demonstrated its character as a compromise between business and labor proposals. Henry I. Harriman, President of the Chamber of Commerce, defended the measure in terms reminiscent of the medieval concept of an abstractly "just price." "The time has come," he said, "when we should ease up on these [antitrust] laws and, under proper governmental supervision, allow manufacturers and

people in trade to agree among themselves on these basic conditions of a fair price for the commodity, a fair wage, and a fair dividend." [1] William Green, President of the American Federation of Labor, welcomed it as "a very definite step forward in industrial stabilization, rationalization, and economic planning . . . the most outstanding, advanced, and forward-looking legislation designed to promote economic recovery that has thus far been proposed." [2] Even the representatives of organized agriculture, who had just cause to fear partial neutralization of the benefits of the recently passed Agricultural Adjustment Act, were willing to accept the measure in the hope that increased mass purchasing power would stimulate the demand for farm products. A few Congressmen were uneasy at its cartellike implications. A few more disliked the grant of potentially dictatorial licensing powers to the President. But the opposition was able to muster only 76 votes against 325. The sole House amendment to Title I, inserted at the request of the A.F. of L., altered the anti-yellow-dog contract provision to forbid, specifically, compulsion to join a "company union."

In the Senate the bill had rougher sailing. Although only a few days had elapsed since labor and industry had demonstrated apparent harmony, business leaders were now seriously worried by the labor provisions. They wanted assurances that the open shop would remain inviolate. On this issue labor forces were able to forestall any change in the bill's wording, but the conflict was an ill omen for the future. On the other hand, industry received a concession of importance in a new clause giving the President power to limit imports when necessary to render code provisions effective. Thus, foreign as well as domestic competition could now be prevented. A further new section provided special regulation for the oil industry.

The most vigorous Senate opposition arose on three grounds. The licensing provisions, viewed askance from the start by business, and accepted only because the Administration promised utmost reliance on voluntary action before resorting to such drastic compulsion, were limited to one year and conditioned upon a prior finding of "destructive wage or price cutting" in the industry concerned. Grave doubts of constitutionality were raised concerning the unprecedented delegation of legislative power, federal regulation of intrastate com-

[1] House Ways and Means Committee, 73rd Cong., 1st Sess., *Hearings on National Industrial Recovery*, p. 134.

[2] *Ibid.*, p. 118.

merce, and wage, hour, and licensing regulation under the due process clause. These objections were swept aside, for alterations to meet them would have destroyed the entire bill. The threat of virtual emasculation of the antitrust laws, however, was too much for agrarian Senators to accept. Lifelong antimonopolists, like Senator Borah of Idaho, insisted on amendments to this provision. Senator Wagner, as spokesman for the Administration, demanded that the bill be left to permit the outlawing of sales below cost. But the Administration could not control the Senate on this point. A provision was added forbidding codes to permit "combinations in restraint of trade, price-fixing, or other monopolistic practices."

Given the previous Supreme Court interpretation of the phrase "restraint of trade," this amendment, had it been allowed to stand, would have removed from the Act all those cartelization privileges which lay at its heart and which had brought forth business support. In conference committee the language was watered down to a mere prohibition of "monopolies or monopolistic practices." So heated was the opposition to this change that, despite the most severe pressure from an extraordinarily popular executive, final Senate approval was granted by a vote of only 46 to 39. Antitrust policy was clearly by no means a dead issue in American politics.

2. The National Recovery Administration

The NIRA became law on June 16, 1933, less than a month after its introduction. In a public statement made on the occasion of its signature, President Roosevelt laid primary stress on its effects in eliminating competition in substandard labor conditions. He also said:

> It is, further, a challenge to administration. We are relaxing some of the safeguards of the antitrust laws. The public must be protected against the abuses that led to their enactment, and to this end we are putting in place of old principles of unchecked competition some new government controls. . . .
>
> Let me make it clear, however, that the antitrust laws will stand firmly against monopolies that restrain trade and price fixing which allows inordinate profits or unfairly high prices. . . .
>
> I am fully aware that wage increases will eventually raise costs, but I ask that managements first give consideration to the improvement of operating figures by greatly increased sales to be expected from the rising purchasing power of the public. This is good economics and good business. . . .

If we now inflate prices as fast and as far as we increase wages, the whole project will be set at naught. We cannot hope for the full effect of this plan unless, in these first critical months, and even at the expense of full initial profits, we defer price increases as long as possible.

The actual terms of the NIRA did not themselves demand application in this manner. Code provisions were limited only by the vague generalities of the Congressional declaration of policy in Section one:

> A national emergency productive of widespread unemployment and disorganization of industry, which burdens interstate and foreign commerce, affects the public welfare, and undermines the standards of living of the American people, is hereby declared to exist. It is hereby declared to be the policy of Congress to remove obstructions to the free flow of interstate and foreign commerce which tend to diminish the amount thereof; and to provide for the general welfare by promoting the organization of industry for the purpose of co-operative action among trade groups, to induce and maintain united action of labor and management under adequate governmental sanctions and supervision, to eliminate unfair competitive practices, to promote the fullest possible utilization of the present productive capacity of industries, to avoid undue restriction of production (except as may be temporarily required), to increase the consumption of industrial and agricultural products by increasing purchasing power, to reduce and relieve unemployment, to improve standards of labor, and otherwise to rehabilitate industry and to conserve natural resources.

So all embracing were these objectives that, assuming the Act to be constitutional, there were virtually no limits to the legal scope of co-operative action. Congress had given the code makers carte blanche. Even the labor provisions of Section 7(a), the least ambiguous of the lot, were to give rise to almost endless disputes over interpretation.

Had the President been able to draw on an experienced civil service; had he been able to formulate concrete policies and translate them into action; had the Administration possessed a clear picture of the desired industrial reorganization; and had a clear policy of general reorganization been grounded on widespread popular support, the NIRA might have formed the basis for a cartelized economy under close government supervision—a planned economy in the proper sense. In the absence of such policies and such administrators, the effects of the Act would depend primarily upon the equi-

librium of forces in code making and administration. This equilibrium would depend, in turn, upon the attitudes and methods of those directly charged with the administration of the statute.

The Act was placed in charge of a new agency, the National Recovery Administration (NRA), under the control of General Hugh S. Johnson as Administrator. He was subject, in turn, to a Special Industrial Recovery Board, consisting of five cabinet members, the Director of the Budget, the FTC chairman, and himself, and also to the President. These other officials, however, were far too busy with their own problems to be of any real influence in NIRA administration. Despite General Johnson's interest in the public works provisions of the Act, and his insistence on their close relation to industrial reorganization as part of a concerted drive for recovery, Title II was put under the control of Secretary of the Interior Ickes and a separate administrative agency.

Immediately under the Administrator were deputy administrators directly charged with code negotiation; at the height of NRA activity they numbered 55, with 151 assistant deputies. A Code Analysis Division served as a channel for code submission from trade associations to the NRA and for the preliminary review of code provisions. The Research and Planning Division, staffed with economists, was to investigate industrial conditions and the economic effects of proposed codes, while the Legal Division was to ensure their harmonization with the requirements of the statute. The entire process of code making and administration, finally, was subjected to the criticism and review of three advisory boards. The Industrial Advisory Board, nominated by the Secretary of Commerce, was to represent the interests of industry as a whole, as contrasted with the interests of a particular industry in any one code. The Secretary of Labor nominated a corresponding Labor Advisory Board. For the Consumers' Advisory Board there was no similar cabinet department; its members were therefore named by the Administrator himself.

The NRA's immediate objective was code negotiation over the widest possible area and in the shortest possible time, in order to gain from NIRA its maximum potential contribution to re-employment. General Johnson's personal sympathies lay with rapid action. He distrusted academic, a priori theorizing and was content to allow policy to develop by precedent. In accordance with the conception of NRA as a co-operative recovery movement, utmost reliance was placed on voluntary codification. The Act's licensing provisions ex-

pired in 1934 without use or even threat of use, while codes were imposed only by the special Federal Alcohol Control Administration set up to supervise the liquor industry. Contingent power to impose codes, however, was undoubtedly a potent force in persuading businessmen to resolve minor differences and organize themselves under the Act. The Administration hoped to concentrate attention at the start on the ten industries employing most men, but its unwillingness to postpone consideration of voluntarily submitted codes made this impossible. The first fifteen codes, all in effect by mid-September, in fact included relatively minor industries like lace manufacturing, fishing tackle, and photographic manufacturing, as well as those of more consequence, such as cotton textiles, wool textiles, shipbuilding and ship repairing, iron and steel, petroleum, automobile manufacturing, electrical manufacturing, and men's clothing. Indeed, by the end of the summer, the NRA was literally flooded with a deluge of proposed codes.

THE PRESIDENT'S RE-EMPLOYMENT AGREEMENT

In an effort to speed up the process of work sharing and wage increases, President Roosevelt cast about for a more immediately effective technique than the necessarily elaborate formulation of semi-permanent codes. Pressure for such action was increased by fears that the speculative boomlet of early summer might soon collapse and by the reluctance of businessmen to accept increased labor costs until competing industries were also codified. A solution was found in the NIRA provision for voluntary agreements. At the end of July, under the impetus of a "ballyhoo" campaign comparable only to a national election campaign or a Liberty Loan drive, over two million agreements were negotiated directly between the President and individual employers.

This President's Re-employment Agreement ("PRA" or "blanket code") contained protection only for labor standards and collective bargaining. Employers agreed not to hire children under sixteen, to reduce the work week to forty hours for white-collar and thirty-five hours for other workers, to maintain specified wage minima ($12 to $15 per week for white-collar workers and 30 to 40 cents per hour for others), to maintain weekly wages despite any reduction in hours, and to respect the guarantees of labor organization in Section 7(a) of the NIRA. Neither acceptance of the agreement nor compliance was required by law. Very widespread acceptance, however, was

secured by the distribution of "Blue Eagle" signs and labels and by a nation-wide campaign for consumer abstention from nonparticipating firms. Voluntary local compliance boards depended in the first instance on social pressure, backed by the threat of Blue Eagle withdrawal after appeal to the NRA itself, and in some cases by the government's refusal to negotiate public contracts with noncompliers. Although only 184 Blue Eagles were withdrawn, and the effect of withdrawal rapidly waned as the public lost interest in the campaign, the method was successful as a short-run expedient. The Blue Eagle retained real significance in the garment industry, where the subsequently adopted Retail Trade code forbade dealing in unlabeled goods.

A leading consequence of the PRA was its added incentive to the negotiation of regular NRA codes. Its wage and hour conditions were often more severe than those contained in proposed codes. And code trade practice provisions offered businessmen the prospect of lessened price competition in return for these labor concessions already granted. Hence applications poured into the NRA office through August and September. By February, 1934, the code-making process was virtually completed. In all, NRA approved 557 basic codes, 189 supplementary codes, and 19 codes jointly with the Agricultural Adjustment Administration.

THE CODE-MAKING PROCESS

Code provisions were of two basic varieties. Those dealing with trade practices were formulated by trade associations or other representatives of industrial interests. But, as a condition of approval, NRA required not only the mandatory labor provision of Section 7(a), but also wage, hour, and child labor regulations on the general lines of the PRA blanket code. In hammering out details of the labor provisions, trade-unions, wherever they existed, played a primary part. Thus, in most instances, code formulation was a process of bargaining for reciprocal advantage between organized business and organized labor, with NRA deputy administrators holding the ring and urging the contenders to agreement. Labor had no objection to price and production controls if they would assure added wage and hour concessions; business could not avoid accepting Section 7(a) and was, by and large, quite ready to place a floor under labor standards if given the *quid pro quo* of market controls. In consequence, almost any trade practice provisions upon which most businessmen of an in-

dustry could agree among themselves became written into their codes and were given the force of law, binding upon the entire industry.

To this result the immediate circumstances of code writing contributed. Original drafts were produced in the offices of trade associations or by industry representatives specially selected for the purpose. They were then discussed informally with a deputy administrator, who was flanked throughout the proceedings by representatives of the NRA Legal and Research and Planning Divisions and advisers from the three advisory boards. It is noteworthy that, despite the prominence of labor provisions in the entire scheme, labor participated in the earliest stages of code preparation only in a handful of highly unionized industries. From the moment of formal submission, however, the adviser from the Labor Advisory Board, in practice chosen to represent labor in the industry concerned, was one of the poles of influence in code negotiation.

After informal preliminary conference, proposed codes were scheduled for formal public hearing. Dissentients of all sorts might be heard, including minority industry groups, distributors, and consumers. The central issues of controversy now became known. They focused, for the most part, on the details of labor provisions. Resolution of controversy took place in closed posthearing conferences, conducted informally and without stenographic records. Deputy administrators, under heavy pressure to get some sort of code into law, exerted themselves to the utmost to effect compromises between the organized interests and among their own official advisers. Deadlock was to be avoided at any cost. Sometimes controverted provisions were inserted for a limited trial period, with subsequent review on the basis of experience. In any case, the deputy's role was that of arbitrator, not of policy maker in his own right. Code approval by the deputy was followed by submission to the Administrator and, finally, to the President, whose signature converted the code into law carrying civil and criminal enforcement sanctions.

While the details of labor provisions were extremely controversial, the broad outlines of NRA labor policy were fixed. Not so with trade practice provisions. In their anxiety to get the system operating, officials consciously postponed decision on broad policy in this field. NRA machinery provided no adequate protection for the interests of consumers or consideration for the repercussions of individual industry codes on the economy as a whole. The Industrial Advisory Board's adviser generally backed up the demands of the particular

industry group sponsoring a code. The Labor Advisory Board was interested almost exclusively in labor provisions. The Consumers' Advisory Board, logically charged with this very function, was well-nigh impotent, for it lacked the backing of an organized constituency. Many of its complaints were received by NRA officials with a deaf ear. The ineffectiveness of his protests against price-fixing provisions led to the early resignation of the Consumers' Board's first economic adviser. Continuous criticism from this source, among others, led eventually to reconsideration of NRA trade practice policy in the middle of 1934. But code making was, by then, practically at an end.

It is not to be supposed that business representatives were united on the terms of desired trade practice provisions. The NRA soon learned that great areas of American industry were not organized in truly representative trade associations. In some cases a number of rival groups submitted strikingly diverse code proposals in the name of the same industry. Long-established trade associations often were found to represent predominantly the larger business units, and their suggestions sometimes met with outraged protest from smaller rivals. Geographical cleavages, interests of integrated or full-line firms as against those specializing in single processes or products, cleavages of size, cleavages between different stages of production, and cleavages between different types of distribution, all served as fruitful sources of dissension. The very definition of an "industry" was a treacherous undertaking. Overlapping of codes became a serious problem. For all the decade of talk about "self-government in industry," industry was in no state to govern itself. A slow, organic evolution on a voluntary basis might have prepared the ground for such an experiment, but here business was thrown pell-mell into the process of writing itself supposedly binding law. Internal dissension in code formulation foreshadowed the subsequent breakdown of compliance.

CODE TRADE PRACTICE PROVISIONS AND ADMINISTRATION

The content and effect of labor provisions have been discussed in Chapter 6.[3] We need not consider them further here, beyond remarking their effect in adding to complexities of code administration and compliance. Labor disputes and disagreement over the effect of Section 7(a) were major factors in the decline of business confidence in NIRA in 1934–35. Congressional action to replace this section, although not the wage and hour provisions, through the National

[3] See above, pp. 173–175.

Labor Relations Act, was well under way before the invalidation of the NIRA in the *Schechter* decision of May, 1935.

Although NRA codes were officially denominated "codes of fair competition," they were, of course, not limited to outlawing trade practices heretofore declared "unfair" at common law or under the antitrust acts. They included anything an industry desired which it could persuade the NRA to grant. Despite innumerable internecine disputes, most industries found that their lowest common denominator of agreed provisions included substantial breaches of the wall heretofore erected by the antitrust laws against concerted activity. Almost every code contained clauses against false advertising, commercial bribery, harassing litigation, and the like, but these were relatively inconsequential. The basis for business support of the NRA was permission for market controls. Such controls generally took the form of direct or indirect limitations on pricing, with less frequent attempts at production control. As NRA officials slowly developed hostility to these provisions, business as a whole lost interest in the Act.

From the start, the NRA disfavored explicit price fixing. Nevertheless, most of the early codes contained provisions limiting individual discretion in the setting of prices. In a few cases, machinery was authorized for the direct setting of price minima. They included bituminous coal, lumber and timber products, and petroleum, with conservation of natural resources as one alleged justification for the measure. In cleaning and dyeing, printing, and a few other localized industries with innumerable small units, similar provisions were established in order to outlaw "ruinous" competition. Over two hundred codes also authorized temporary minimum price fixing for the duration of an emergency declared by the Administrator. Although actually applied in only nine industries, such price fixing was undertaken over an extended period for retail tobacco, ice, wastepaper, and, most important, for retail solid fuel. In the great bulk of codes, however, reliance was placed on a clause forbidding "sales below cost." Determination of cost was to be made generally in accordance with uniform accounting techniques prescribed by the code authority. In the retail distributive trades an effort was made to eliminate "loss leaders" [4] by prescribing a low minimum-percentage markup on all

[4] This term has no commonly accepted, precise definition. It may mean sales at a price below invoice cost, or at a markup less than the average cost of doing business, or at a markup less than that generally made. Its effect depends on the price being lower than buyers have been led, either by advertising or by experience, to expect.

goods. Well over half the codes prescribed sales in accordance with an open-price system, the earlier ones requiring a waiting period between filing price changes and putting them into effect. In order to secure adherence to filed prices and minimum price provisions, finally, the codes rigidly confined permitted variations in terms of sale, including discounts, credit terms, guarantees against price decline, advertising allowances, returns of unwanted merchandise, combination sales, and gifts of premiums. Resale price maintenance, although requested in the original version of the retail drug trade, was forbidden by the NRA.

Complete regulation of output, like direct minimum price fixing, was sanctioned by the NRA almost exclusively for natural resource industries, although the glass container code also contained such a provision. Code authorities for lumber and timber products, copper, and petroleum all set maximum output figures and allocated production or sales quotas to individual firms. Four industries sought to limit production indirectly, by forbidding manufacturers to accumulate inventories beyond a specified proportion of their capacity. In another group of codes led by cotton textiles, which was the first to be approved, a limit was placed on weekly hours of operation of plants. A larger group sought to restrict long-term investment by forbidding acquisition of new machinery or entry of new units into the industry without special authorization.

Other more or less common provisions affecting market conditions included basing-point systems, limitations on the area of distribution for each manufacturer's products, and attempts to favor one or another distributive channel against its rivals. In addition, each code contained provisions outlawing various competitive tactics peculiar to the particular industry.

Just as Congress had rid itself of responsibility for decisions of policy by handing to the NRA and to trade associations the duty of crystallizing the vague terms of the Act into code provisions, so the NRA itself often passed on the burden of decision by accepting code provisions so vague that their real effect could become known only in actual day-to-day administration. The ultimate locus of the legislative powers so grandiosely delegated by Congress to the President was in the code authorities set up to administer the new law for separate industries. In industries organized into well-established trade associations before the passage of NIRA, the association board itself was often constituted the code authority. In other cases, special committees

were rapidly formed in order to sponsor codes, and they frequently became heirs to their administration. Industry-wide elections to authorities were sometimes conducted. Minority groups were generally guaranteed representation of some sort. In twenty-three cases labor was given voting representation, and in twenty-eight others membership on the authority without vote. Where intraindustry differences were sharp, and where firms were large in number and widely scattered, recruitment of a code authority often proved a difficult problem. Complaints of inadequate representation troubled the NRA throughout its career. They originated most frequently with smaller firms, and were often justified. In the striking case of the iron and steel industry, the three largest members were given 757 of a total of 1,428 votes, although forty firms were included in all. Widespread friction and numberless complaints arose also from the problem of financing the $45,000,000 annual code authority budgets through levies on industrialists.

For the first few months of operations under the Act, direct contact between code administration and the body of NRA officials was maintained only through the deputy administrator who had negotiated the original code. The plan was systematized toward the end of 1933 by the designation of one to three "administrative members" as nonvoting participants on code authorities. Burdened as they were with the heavy duties of formulating new codes, the deputies could give only scant attention to the task of administrative supervision. They were later replaced with men chosen from outside the NRA and paid for attendance at authority meetings on a per diem basis. This expedient also proved unsatisfactory. It was finally decided at the end of 1934 to employ full-time administrative representatives with well-defined liaison duties. By then, however, the NRA was already hopelessly entangled in conflicts over reformulation of policy. In the crucial early days, the code authorities were left almost wholly to their own devices.

THE DEVELOPMENT OF POLICY

The NRA soon had reason to regret its lack of foresight in failing to consider trade practice policy in general terms at the start. As is suggested by the foregoing sketch of typical provisions, the Administration had permitted outright cartelization only in a few natural resource industries, but had handed over to code authorities elsewhere

the means for substantially influencing their markets. Despite President Roosevelt's plea for the longest possible postponement of price increases, no effort had been made by the NRA to set up either incentives for voluntary compliance or machinery for compulsory enforcement of such postponement. It is not surprising that business concerns began, in many cases, to exploit to the full the monopolistic potentialities of their newly enacted codes. Accounting procedures, which were developed in connection with prohibitions of sales below cost, frequently attempted to include in costs a profit element, thus converting the provision into a legislative guarantee of business success. The waiting period attached to open-price systems was used to bring pressure to bear on price cutters. Industries supplying materials for public works took full advantage of the new demand by concertedly increasing prices. Separate groups within industries sought to use code provisions to redistribute business in their favor.

The sudden and widespread reorganization of industrial habits engendered by the NIRA was bound to upset the pre-existing balance of commercial advantages and disadvantages in thousands of individual cases. Complaints from the losers, and from those dissatisfied with their gains, began to flood the NRA and Congress. The furniture code authority, for example, complained of the effect on prices of cartelization under the lumber and timber products code. Small businessmen were particularly vociferous. They were less well equipped in the first place than their larger competitors to absorb the increased costs of the labor provisions. Again, when open-price systems prevented their competition on a price basis, they were unable to offer as effective nonprice inducements to consumers. They felt discriminated against in the composition of code authorities. Authority members were sometimes accused of making illegitimate use in the competitive struggle of confidential information submitted by rivals in accordance with open-price systems. Provisions like the elimination of three-shift operations in cotton textiles, which tended to transfer business from Southern to Northern mills, evoked a crop of complaints on sectional grounds. Large consumers and farm organizations also put forward a series of protests. Senator Nye of North Dakota, who had helped lead the Senate fight against antitrust law exemption, alone received over fifteen thousand complaints before the NIRA had been on the books for six months. Government authorities letting public contracts were so harassed by the chronic receipt of identical bids that President Roosevelt issued an Executive Order in March,

1934, permitting bidders on such contracts to cut their openly filed prices by 15 per cent.

The swelling volume of complaints against the NIRA, reinforced by attacks in Congress, led the President in the spring of 1934 to appoint a National Recovery Review Board, headed by Clarence Darrow, to investigate the extent to which NRA codes were "designed to promote monopolies or to eliminate or oppress small enterprises or operate to discriminate against them or permit monopolies or monopolistic practices." The Board's reports were a smashing indictment of the entire NRA scheme. They termed it "monopoly sustained by government," and "not a planned economy but a regimented organization for exploitation." Although the Darrow Board's investigation was somewhat unsystematic and reflected strong personal bias on the part of its members, which tended to detract from the effectiveness of its criticisms of detail, it helped to crystallize the growing opposition to the NIRA as then administered.

Such outside remonstrances gave added vigor to those Cassandras within the NRA, mostly on the staffs of the Consumers' Advisory Board and the Research and Planning Division, who had always viewed with misgiving the legalization of price and production controls. Throughout the year 1934 there developed inside the organization a steady evolution of substantive policy and of administrative machinery for the formulation of such policy. Codes were first classified into industry divisions, and division administrators were installed to relieve the intolerable burden of work on the one-man head. Various so-called "policy boards" had been set up after September, 1933, but the early ones were composed of ex officio members already overburdened with more immediately pressing regular duties. A few months later a review division was formed, charged with examination of code interpretations and administrative orders and rulings, and also with the review of approved codes in their actual operation, in order to eliminate inconsistencies and bring the working schemes into harmony with developing policy. The first real opportunity for considered policy formation, however, came only after the establishment in March, 1934, of an NRA administrative staff, including a full-time administrator for policy. Under him were three deputies, for trade practices, labor provisions, and code authorities, respectively. Each deputy was aided by full-time representatives from the two regular service divisions and the three advisory boards. The new policy officials frankly discarded General Johnson's earlier attitude of

developing policy only by precedent, by trial and error. They set out to formulate principles upon which error could be judged. They adopted guiding criteria for judging the effects of the NIRA in terms of short-run recovery, expansion of national production, consumption, and employment, and "the preservation of competitive and prevention of monopolistic tendencies." This last criterion went directly counter to the most important trade practice provisions implanted in the codes. The resultant detailed policy pronouncements would have seriously limited the market control powers of code authorities. But, by the time they were set forth, four fifths of the codes were already in effect.

Prohibitions of sales below cost had already been reconsidered to some extent. The ambiguity of such provisions and their potentialities as price-fixing devices and as a means of favoring special groups within an industry, which should have been evident on a priori grounds, were soon forcibly made known to everyone concerned. The Administration became increasingly strict in its supervision of accounting techniques, disallowing a variety of artificial cost elements. It had at first been assumed that the cost referred to, whatever the definition of its components, was cost to each individual firm. Rigid adherence to such a requirement would have put all but the lowest cost producers out of business. Pressure arose, therefore, to redefine costs in terms of some industry average. More commonly, exceptions were made permitting price cutting in good faith to meet competition. This rule, however, easily led to nullification of the entire provision. The NRA also experimented for a while with a price floor based on "lowest reasonable cost" of a "representative firm," to be determined by an impartial agency. Meanwhile, the task of compliance and enforcement had to be met. Reliance was wisely placed as long as possible on extralegal compliance measures, but the efficacy of the ultimate legal sanctions eventually had to be put to the test. Constitutional difficulties, hostile courts, and a public opinion averse to condemnation of dealers for selling at low prices soon proved the task of enforcement to be impossible. The policy group recommended that "the inclusion of cost protection provisions in codes . . . is unsound and unwise policy except in cases of declared emergency."

A similar tale could be told with regard to open-price provisions. The policy group favored price filing on principle, but strongly opposed what it considered the price-rigidifying requirement of waiting

periods before prices might be altered. Yet it was often precisely this feature which endeared the system to businessmen. "Loss leader" prohibitions were also condemned. Recommendations were made against machine-hour limitations and against direct restrictions on output. The new attitude, in short, was a radical retreat from all those cartellike implications which had, at least in the minds of the sponsoring business groups, been the very core of the NIRA.

Announcement of the new policy produced a storm of resentment. Any thought of general code revision was hastily discarded. New codes were required to conform, as were old codes when subject to revision on some other account, but the bulk of enacted codes was left untouched. And enacted codes included by far the larger part of American industry. Thus, the NRA entered a stage of irresolution and suspended animation, in which it supervised the administration of codes openly in conflict with its announced general policy. By the autumn of 1934 the experiment was visibly deteriorating. Compliance difficulties contributed forcibly to this decay. Elaborate compliance machinery could not disguise the bare fact that much of the code verbiage was unenforceable. Enforcement was successful in close-knit industries dominated by a few large units; there the legal sanction was least needed. Elsewhere the breakdown spread in ever-widening circles through successive industries, carrying away with it the confidence of the public and the morale of NRA personnel. Increasing uncertainty arose both as to the constitutionality of the Act and as to the likelihood of Congressional extension beyond the original two-year limit.

In September, 1934, the NRA was reorganized at the top. Personal attacks on the Administrator, coupled with a degree of physical exhaustion from his immense burden, led to his resignation. He was replaced by a four-, and later seven-man, National Industrial Recovery Board, with two members identified with labor, two with business, one with consumers, and two without special interest. President Roosevelt, in announcing the appointment, said:

> It is now time to review these actions as a whole to determine through deliberate means in the light of experience, from the standpoint of the good of the industries themselves, as well as the general public interest, whether the methods and policies adopted in the emergency have been best calculated to promote industrial recovery and a permanent improvement of business and labor conditions.

The Board undertook a gradual appraisal of the problems of administration and of policy facing the NRA. With the coming expiration of the Act hanging over it from its inception, it was more interested in laying the groundwork for extension than in attempting a hurried reform of the existing order. Wholesale code revision was postponed. The Board began seriously to consider whether, in the absence of monopolistic privileges, the business world would continue to co-operate on a voluntary basis; and how far, as an alternative, an imposed codification of the economic order was desirable or feasible.

THE END OF THE NIRA

When the Seventy-fourth Congress assembled early in 1935, it had to face squarely the question of NIRA extension. Continuation of wage and hour protections was generally favored. The breakdown of Section 7(a), described in Chapter 6, had aroused the forces of organized labor. They demanded strengthening of this provision, either as part of a new NIRA or in separate, permanent legislation. Their efforts succeeded in securing the National Labor Relations Act at the end of the session. Sentiment on the trade practice provisions was more sharply divided. In the Senate, particularly, a clear majority stood for complete restoration of the antitrust laws or, at a minimum, substantial curtailment of code authority powers. Leadership on this issue lay with Senators from the agricultural states, always the outstanding supporters of a vigorous antitrust policy. This situation was recognized in a special message of President Roosevelt on February 20. He called for a two-year extension of the NIRA, declaring that "the fundamental purposes and principles of the Act are sound. To abandon them is unthinkable. . . . It would spell the return of industrial and labor chaos." Taking his cue from the altered policy of the NRA itself, however, he called for elimination of "monopolies and private price fixing. . . . We must make certain that the privilege of co-operating to prevent unfair competition will not be transformed into a license to strangle fair competition under the apparent sanction of the law. Small entrepreneurs especially should be given added protection against discrimination and oppression."

In accordance with these proposals, a bill was drafted by the National Industrial Recovery Board, in co-operation with other executive agencies, and introduced into the Senate. The opponents of the NIRA were able to secure a resolution for general investigation of

operation of the Act, with special reference to its effect on small business. In seven weeks of open hearings, the Senate Finance Committee was deluged with charges and countercharges, dozens of small business leaders testifying to their difficulties under the Act and the NRA itself coming valiantly to its defense by showing the greatly reduced business mortality rate since 1933. But the opposition was now in the saddle. By a vote of 16 to 4 the Finance Committee reported out the Clark resolution, continuing the Act for only ten months, forbidding price fixing under code provisions except under government supervision in natural resource industries found by the President to be "affected with a public interest," and excluding from its operation "any person whose business is wholly intrastate." All existing codes were to expire in thirty days unless revised to conform to the new requirements. This resolution passed the Senate without a record vote on May 14.

The Clark resolution, if made law, would have killed the NIRA. The experiment's progressive deterioration, fostered by administrative unwillingness to implement new policies until a reasonably clear future could be seen, would simply have been accelerated. Review of the entire code structure in thirty days was physically impossible. Ten months was too short a time in which to rebuild an effective administrative system. The proposed substantive limitations on code provisions were of uncertain effect. The administration, therefore, put forward in the House a compromise measure, providing (1) two-year extension; (2) exemption of small or local enterprises "which do not substantially affect interstate commerce"; and (3) elimination of concerted price fixing except under government control "in order to prohibit discriminatory price cutting, or otherwise to protect small enterprises against discrimination or oppression, or to deter the growth of monopolies, or to prevent the waste of mineral natural resources." The compromise was favored by a majority of the House Ways and Means Committee. At this juncture, however, the legislative process was suddenly cut short by the sweeping decision of the Supreme Court in the *Schechter* case,[5] handed down on May 25, 1935.

A unanimous Supreme Court declared the NIRA unconstitutional on two grounds: (1) that it delegated legislative power to the President without adequate standards to guide him in its exercise, and (2) that it invaded the field of intrastate commerce reserved to the

[5] *Schechter* v. *United States,* 295 U.S. 495 (1935).

separate states. So broad were the standards in Section one, the "declaration of policy," said Chief Justice Hughes, that "the discretion of the President in approving or prescribing codes, and thus enacting laws for the government of trade and industry throughout the country, is virtually unfettered." The second issue was discussed in connection with the code immediately concerned, a joint NRA-AAA code for the live poultry industry of the New York metropolitan area. The process of poultry slaughtering was held to be neither "in interstate commerce" nor sufficiently "affecting interstate commerce" to justify federal regulation of wages and hours. The Court distinguished between "direct" and "indirect" effects. It quoted with approval an earlier dictum from an antitrust case against the building industry:

> The acts here complained of spent their intended and direct force upon a local situation—for building is as essentially local as mining, manufacturing, or growing crops—and if, by resulting diminution of the commercial demand, interstate trade was curtailed either generally or in specific instances, that was a fortuitous consequence so remote and indirect as plainly to cause it to fall outside the reach of the Sherman Act.

The government's argument that state regulation was impossible, because of the competition of low-standard business in other states, was swept aside. "It is not the province of the court to consider the advantages or disadvantages of such a centralized system. It is sufficient to say that the federal constitution does not provide for it."

The first ground raised no insuperable obstacle to NIRA extension. The desirability of more concrete Congressional definitions of code policy had been recognized for some time on all sides. It was also generally felt that code authorities had had far too free a hand in exercising governmental power. The various bills for continuing the Act were all in accord with the Court on this issue. But the reaffirmation of a narrow definition of interstate commerce was another matter. Taking the words of the Court at their face value, the nation's entire manufacturing and mining business—everything other than transportation and trade—was beyond the power of federal regulation of any sort whatever. Hence the President's reference to the decision as appropriate to the "horse-and-buggy" era. Code enforcement came to an end at once. Congress passed a ten-month continuing resolution repealing all compulsory features of the Act, but leaving antitrust law exemption for voluntary agreements which protected labor standards.

Reactions to the *Schechter* decision were varied. The more conservative sections of the press welcomed it as putting an end to experiments in government regulation of industry. Organized labor condemned it and expressed a determination to press for substitute legislation to protect independent organization, wage and hour standards, and abolition of child labor. The business community was divided. Regret at the loss of opportunities for market control was tempered by satisfaction at the termination of Section 7(a) and by realization that the Administration was, in any case, heading rapidly away from the grant of anything savoring of monopolistic privilege. In September the Federal Trade Commission was authorized to approve trade practice provisions in voluntary NIRA agreements, provided that they also contained labor provisions satisfactory to the President. The new procedure had the qualified blessing of the Chamber of Commerce. Twenty-two industries submitted such agreements, but in not a single case did their labor provisions receive Presidential approval. Since antitrust law exemptions were no longer granted, businessmen could derive the same benefits from Trade Practice Conferences without labor concessions as from NIRA voluntary agreements with very substantial labor concessions. Thus, the NIRA expired completely in April, 1936. The Blue Eagle had died an ignominious death.

LESSONS OF THE EXPERIMENT

The NIRA was a failure, substantively and administratively. Precise evaluation of it in relation to general economic recovery is impossible, since so many factors were at work. It unquestionably contributed to the short-lived boom of the early summer of 1933, which was based largely on purchasing in expectation of increased prices. Its reduction of the average working week doubtless aided in the re-employment of some two million workers. But the larger economic improvement which lasted from 1933 to the beginning of 1937 was probably hampered rather than encouraged by the increased costs and prices attributable to the NIRA. Its successes were important in themselves, but relatively insignificant in the broader picture. They included a very marked reduction, although not abolition, of child labor, a diminution of sweatshop labor conditions, encouragement to independent labor organization, and some elimination of clearly undesirable commercial practices. These results could

have been achieved with far less effort and far less elaborate administrative machinery.

As an attempt at basic reorganization of the American economy, the NIRA encountered a fundamental dilemma. The degree of minute governmental interference and control which would be required to prevent abuse of a privately cartelized economic order was found to be immense—far beyond what "economic planners" had envisaged and far beyond the point of acceptance by American business or the general public. Cartelization without effective supervision, on the other hand, at once produced a flood of complaint and a powerful movement for restoration of antitrust policy. NRA officials themselves proved unwilling to accept the logical consequences of the codes they had approved. The widespread contention that antitrust policy was an anachronism without real public support, the hobby of a handful of academic economists and misguided Senators, proved to be an utter delusion.

The lessons of administration were far clearer than the lessons of policy. The essential defect of the NRA, from this point of view, lay in its attempt to do too much too quickly, without adequate personnel and without advance elaboration of guiding lines of policy. Accomplishment of the mere physical task of industry codification in six months was a remarkable feat of administration. But the NRA was infected with a feverish desire for action almost regardless of consequences. Trial and error is no substitute for policy making, for only policy making can erect criteria for the recognition of error. Congress had not determined policy when it passed the Act; the NRA did not approach this task, as far as trade practice policy was concerned, until codification was almost universal. The NRA was most successful in administering its labor policy, which was relatively well defined in advance. The immediate motive for combining labor and trade practice provisions in single codes under a single administrative body may have been justified; it was felt that an exchange of labor concessions for trade regulation privileges would most effectively evoke the support of the business community. For longer run administration, however, the purposes and necessary techniques of control in the two areas are so widely separated as to suggest the full attention to each of a special government agency. Chronic outbreaks of friction between the NRA and the FTC, moreover, demonstrated the need for co-ordination of various agencies dealing with trade practice regulation.

Experience under the NIRA also illumined for the future the boundaries of administratively feasible "self-regulation of industry." To permit associations of businessmen to make voluntary agreements among themselves, subject to compelling sanctions for observance by members, is clearly within the realms of possibility, whatever may be thought of its desirability. To let such associations make agreements which are part of the law of the land, imposing criminal penalties on industry members whether voluntary parties to the agreement or not, is impracticable save within very narrow limits. Much of the "law" written into NRA codes was literally unenforceable. The difficulty of achieving voluntary agreement over industry-wide areas was also strikingly displayed. Identity of interest and purpose among all industrialists except for the "chiseling 10 per cent," which so many proponents of industrial self-regulation took for granted, proved to be illusory. The complexity of American business physiology was made known during these years for the first time. So, likewise, was the inadequacy of available statistical materials for effective planning and for predicting the results of particular measures.

Finally, and most important, the practical difficulties which came to beset NRA officials in 1934 and 1935 suggest a basic misconception at the heart of the NIRA. It sought to evoke an industrial order operating in the public interest out of the interaction of organized partial interests in separate industries taken one at a time. It was thought that whatever was mutually agreeable to the industrialists, the workers, and (to a lesser extent) the consumers of separate industries would magically combine into a harmonious pattern for the whole industrial sector of the economy. This thought was confused with the older concept that "what is good for business is good for the public." But this concept depended upon the hypothesis of competition as the "invisible hand" guiding entrepreneurs willy-nilly toward public service, and here competition was largely forsaken. While individual industries, including their workers, may benefit from lessened production and increased prices provided that they are not followed by others, over-all application of such a principle can clearly lead only to over-all impoverishment.

3. After the NIRA—The Attack on Mass Distribution

With the ending of the NIRA, the pre-1933 legal situation was re-

stored. Progressive general economic improvement, coupled with widespread discontent under that Act, had greatly weakened the pressures for antitrust law modification. There were a few sporadic efforts during the next few years, mostly inspired by groups of smaller businessmen, to revive a qualified type of NRA code agreement under general legislation. Most widely publicized were the recommendations during 1936 of a voluntary "Council for Industrial Progress," composed of labor and business representatives conferring under the supervision of a temporary federal official known as the "Co-ordinator for Industrial Co-operation." They proposed to outlaw "destructive competition" by a general statute, including prohibitions of loss leaders, price cutting, selling below cost, and unfair labor conditions. In addition, they suggested administrative approval of voluntary agreements on labor standards and trade practices, with antitrust law exemption whenever such co-operative action promoted "the maintenance of fair methods of competition in the public interest." Prominent individuals, including Donald Richberg, one-time chairman of the National Industrial Recovery Board, have also made similar proposals from time to time. NRA experience, however, had shown the delusive ambiguity of many such phrases when written into law. Moreover, until the Supreme Court's epoch-making expansion of federal authority under the commerce clause in April, 1937, constitutional limitations, as well as Administration antipathy, made such suggestions impracticable. A highly attenuated type of cost protection, of doubtful significance, was offered by the FTC's inclusion in Trade Practice Conference Group I rules of prohibitions on loss leaders and sales below cost "with the purpose and where the effect may be to suppress competition, restrain trade, or create monopoly."

While revival of the NIRA in general terms was out of the question, separate groups which had benefited most markedly under its provisions now demanded special legislation to achieve the same results. Organized labor was most successful in this effort. The National Labor Relations Act of 1935 and the Fair Labor Standards Act of 1938 replaced Section 7(a) and the wage, hour, and child labor provisions of NRA codes. The bituminous coal industry likewise received special attention in the Coal Acts of 1935 and 1937, described below in Chapter 17. A third group demanding statutory protection in lieu of the NIRA was composed of organized wholesalers and independent retailers, who were engaged in a struggle against the

newer forms of mass distribution. They were rewarded with three types of new legislation: the Robinson-Patman Anti-price Discrimination Act of 1936 and correlative State Unfair Trade Practices Acts; the legalization of resale price maintenance; and special taxation of chain stores.[6]

The underlying causes of the contemporary struggle over channels of distribution have been described in Chapter 14.[7] The trend toward the newer forms of mass distribution, perceptible ever since 1900, was greatly accelerated by the depression. Consumers became more concerned with minor price savings and more ready to forego the privileges of convenient location, credit, delivery, and return offered by independent retailers of the traditional hierarchy. The falling volume of business, with overhead costs fixed, intensified the competitive pressures. The bankruptcy rate shot up among small retail units, and to a lesser extent among wholesalers. Finding themselves in an exposed economic position, with the threat of extinction on the horizon, the independents joined forces to promote protective legislation. Aided by manufacturers who feared the concentrated bargaining power of retail chains, mail-order houses, and large department stores, the independents have constituted one of the most effective lobbies seen in recent years, both in Washington and at the state capitals.

It is claimed by the independents that the relatively low prices by which mass distributors attract custom are based, in part, upon illegitimate competitive methods. Articles carrying nationally advertised brands, or unbranded staples familiar to the buying public, are sometimes sold as "loss leaders." The practice is challenged as deceptive, on the ground that buyers are led to expect similar savings on everything in the store, or in some cases find that a higher price or inferior quality substitute is "pushed" on them by salespeople. It is particularly damaging to single-line dealers like booksellers or tobacconists, who may lose their entire trade to multiline stores employing popular novels or cigarettes as loss leaders. It may be defended, on the other hand, as a form of advertising no more deceptive to the sensible consumer than competing forms, and more advantageous to him in that he benefits directly from the lower price. Independent retailers have sought to outlaw loss leaders both through the legalization of

[6] Chain store taxation was first imposed by a few states in 1927, but the movement became widespread only after 1935.

[7] See above, pp. 496–499.

resale price maintenance and through direct statutory prohibitions of sales below cost.

A more significant element in the struggle turns about the mass distributors' advantages in their own buying prices. If part or all of this differential could be outlawed, the independents would benefit very substantially. They concede the legitimacy of quantity discounts based on a manufacturer's actual savings in cost, but argue that in practice the bargaining leverage of their large rivals induces price concessions well beyond that point. In some fields manufacturers cannot dispense with the distributive outlets of a large chain. At times, it is claimed, smaller manufacturers are induced to extend their plant or reduce their sales force on the basis of regular large orders from a single purchaser, and are then in so dependent a position that their prices can be forced down to bare out-of-pocket costs or even, for short periods of time, below. The actual extent of such "bludgeoning" tactics is impossible to know, although numbers of individual instances have been brought to light. By contrast, the mass distributors point to the advantage of large orders, not solely in lowering manufacturers' selling costs, but also in enabling them to employ their plant more regularly and thus to reduce per unit overhead costs. And they see nothing illegitimate in asking manufacturers to allocate the savings in overhead to their own orders, which, in their minds, "make the savings possible." The Robinson-Patman Act, sponsored predominantly by grocery wholesalers and independent retailers, was designed to reduce advantages of this sort.

Under the NIRA, rival distributive groups had sought to use code machinery to improve their competitive positions. Mandatory minimum markups, prohibitions upon sales below costs, direct limitations on distributive channels, and mandatory customer classifications, with standard discounts for each class, were all tried in one or another code for the distributive trades. Loss leader sales were effectively discouraged in some fields, although toward the end the difficulties of enforcement were leading to progressive breakdown. Moreover, in keeping with the general trend of NRA policy against code provisions "freezing" the advantages of vested interests, the Administration became increasingly hostile to such codes, especially in regard to mandatory customer classification. While supporting NIRA extension, therefore, the forces opposed to mass distribution had begun to promote special supplementary legislation, state and federal, some time before the *Schechter* decision.

THE ROBINSON-PATMAN ACT

In its original form, the Robinson-Patman Bill was frankly announced as an anti-chain store measure. It was drafted by counsel for the United States Wholesale Grocers' Association. It took the form of an amendment to Section two of the Clayton Act, the provision against price discrimination. We have already seen how efforts were made during the twenties to apply this section in the struggle over distributive channels.[8] It offered insufficient protection against the buying advantages of mass distributors, since it failed to limit quantity discounts to manufacturers' actual savings and made no reference to disguised price concessions to the distributor in the form of payments in lieu of middlemen's services, like brokerage, or payments for special services, like store advertising. In its final report on chain stores, in 1934, the FTC had pointed out the inefficacy of this section. The Commission recommended a general prohibition of "unfair" or "unjust" price discrimination, direct or indirect, without excepting provisos, leaving to the courts authority to determine the extent to which particular concessions might be deemed "fair," "just," or "nondiscriminatory." Wholesalers and independent retailers, however, demanded more specific protection.

Congressman Patman introduced the bill only a fortnight after the demise of the NIRA. It would have proscribed price discrimination regardless of its effect on competition, with only two exceptions. Trade discounts were to be permitted if based on a classification of customers itself based on the buyer's customers (i. e., classifying chain stores as retailers). And quantity discounts would be allowed "which make only due allowance for differences in the cost of manufacture, sale, or delivery resulting from the differing methods or quantities in which such commodities are to such purchasers sold or delivered." The bill also forbade brokerage payments by buyers to persons controlled by sellers, and outlawed indirect price concessions on account of special services, unless offered on "proportionally equal terms" to all buyers. The measure was vigorously supported by wholesale and retail grocers and druggists, and by independent food brokers. Opposition came from chain stores and mail-order houses. Manufacturers were in an equivocal position, for they desired relief from the bargaining power of large buyers without sacrificing extremely valuable marketing channels. They therefore favored the

[8] See above, pp. 496–499.

bill with substantial modifications and, in the final result, probably gained more than any other single group.

The bill was carried over the summer of 1935 and reached the stage of Senate consideration only in March, 1936. The mass distributors had now rallied their forces and organized a defense. They had been sufficiently warned that, as one Congressman put it, "it is the purpose of the Congress and the country to try to save the opportunity for the little fellow to stay in business. . . . I think the country is getting rather determined not to turn over the whole business of this country to those chains and things of that sort." [9] Congressional opponents of the chains had also sought to weaken their position by an elaborate investigation of lobbying activities of the American Retail Federation, a group allegedly dominated by department and chain stores masquerading behind a "front" of independents. Clearly unable to prevent passage of the bill in some form, the mass distributors concentrated on amendments to weaken its effect on their position. They were aided by the possibility of constitutional obstacles if the bill went beyond "equalization" of competitive positions. They gave their support to a much milder measure sponsored by Senators Borah and Van Nuys, which provided criminal penalties for giving or receiving discriminatory advantages through discounts, rebates, allowances, or advertising service charges, in respect of goods of "like grade, quality, and quantity," and also forbade geographical price discrimination "for the purpose of destroying competition or eliminating a competitor."

In the end, both bills were written into law as separate sections of the Robinson-Patman Act, but with the Patman Bill greatly modified. As enacted, it forbade price discrimination in interstate commerce "where the effect . . . may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them." Exceptions were made for discounts making "only due allowance" for cost savings resulting from differing methods of sale or differing quantities, but it was stated that the FTC might limit quantity discounts if purchasers in large quantity were so few that the price saving would be "unjustly discriminatory or promotive of monopoly." The burden of justification

[9] Chairman Sumners, in H.R. Judiciary Committee, *Hearings to Amend the Clayton Act*, 74th Cong., 2d Sess. (1936), Part 2, p. 385.

for discriminations (by which the law presumably meant price *differences*) was placed on the seller, but he might rebut a prima facie case against him by showing that a lower price was made in good faith to meet competition. Brokerage payments were now forbidden to persons controlled by buyers "except for services rendered." Concessions for special services had to be offered to all buyers on "proportionally equal terms." The Borah–Van Nuys Bill was included without alteration.

The Act contains evidences throughout of ambiguous draftsmanship adopted in the effort to compromise rival interests. Its ultimate practical effects will depend to a large extent on judicial construction. Up to the end of 1940, only the brokerage clause had had its day in court, where its constitutionality was sustained and its provisions interpreted strictly against payments to brokers under the control of large buyers.[10] The limitation of quantity discounts to cost savings, which is the heart of the Act, has so far been interpreted only by the FTC. Realizing the complexity of the statute, the Commission has moved slowly in its enforcement, encouraging voluntary compliance through informal conferences and suggestions for revised discount scales.[11] Co-operation has generally been forthcoming. Establishment in a formal suit of a cost defense to alleged discrimination involves the possibility of almost interminable disputes between rival expert accountants, so much so that it has been suggested, not entirely facetiously, that the accountants' profession is the Act's chief beneficiary.[12]

Two early formal complaints were dismissed on the ground that some requisite criterion of the statute was unsatisfied. In one, a floor-covering manufacturer's 20 per cent discount to a mail-order house

[10] *Biddle Purchasing Co.* v. *FTC*, 96 F. (2d) 687 (1938); *Oliver Brothers* v. *FTC*, 102 F. (2d) 763 (1939); *Great Atlantic and Pacific Tea Co.* v. *FTC*, 106 F. (2d) 667 (1939); *Webb-Crawford Co.* v. *FTC*, 109 F. (2d) 268 (1940); *Quality Bakers of America* v. *FTC*, 114 F. (2d) 393 (1940). The Supreme Court has refused to review three of these decisions on petitions for *certiorari.*

[11] From the passage of the law to June 30, 1940, the FTC made 853 investigations, over one quarter of which were in the food trade. Formal complaints averaged about twenty-five per year. Only a few complaints were contested; in the remaining cases, the issuance of cease and desist orders followed as a matter of course. On the whole, care has been taken to restrict complaints to situations which are clearly illegal.

[12] In the summer of 1939, the Commission began a general study of accounting practices, with special attention to distribution accounting. This investigation was undertaken largely to assist in the application of the Robinson-Patman Act and corresponding state laws. The report was to be published during 1941.

was justified as less than his actual cost savings.[13] In the other, a cheese company's quantity discounts to retailers were held not to have injured their competitors, and in any case to be within the cost savings.[14] It soon became evident that cost savings on account of quantity sales were much larger than the Act's sponsors had supposed, that the FTC was inclined to accept reasonable cost defenses, and that the proof of injury to competition would be a matter of some difficulty. Indeed, to the extent that large quantity discounts are found to be warranted by savings, the Act's spur to more rigorous accounting methods may tend to increase, rather than decrease, the buying advantages of mass distributors. On the other hand, the Commission has attacked a number of quantity discounts based on total purchases over a period of time, or on combined purchases of a number of associated store units when deliveries are made to each store separately.[15] Another important proceeding resulted in an order against the United States Rubber Company, forbidding tire sales under private brand to Montgomery Ward and several large automobile-supply chains, at a price differential from sales of its own brand to independents not justified by cost differences.

The Commission has also used the Act in its campaign against basing-point systems. It has sought in several instances to attack an entire series of related discriminations, in order to avoid temporary unfair competitive advantages as a result of prosecution, and also to forestall the defense of an action under attack as made in good faith to meet competition. On the whole, the FTC has thus far attempted to strike a reasonable balance between application of the Act to forbid clearly unwarranted discrimination, on the one hand, and avoidance of undue rigidification of distributive methods on the other. How its orders will fare in the courts, however, remains to be seen.

The total benefits to independent distributors under the Robinson-Patman Act have been relatively small. Manufacturers, particularly in the food industry, appear to have been more fortunate, for the Act has given them an opportunity to resist the demands of large buyers for special brokerage and advertising allowances. Under these conditions the fight against mass distribution has been pursued with vigor along other lines.

[13] *Bird and Son, Inc.*, 25 FTC 548 (1937).

[14] *Kraft-Phenix Cheese Corp.*, 25 FTC 537 (1937).

[15] See, for example, *Standard Brands, Inc.*, 29 FTC 121 (1939); *Anheuser-Busch, Inc.*, Docket No. 2987 (1940).

STATE UNFAIR TRADE PRACTICES ACTS

Parallel with the pressure for new federal legislation, opponents of mass distribution have promoted similar state statutes to cover the field of intrastate commerce. The movement began in California in 1931 and spread very rapidly after 1935. The laws are of two general types: antiprice discrimination acts, similar to the Robinson-Patman Act, and prohibitions of sales below cost, frequently limited to the distributive trades. By the summer of 1940, provisions of both types were in force in sixteen states, while eighteen additional states had one or the other. Among the more populous states only New York, Illinois, Ohio, and Texas were absent from the list; in New York, a statute outlawing sales below cost was passed by the legislature in 1939 but vetoed by the Governor.

Antiprice discrimination laws are designed primarily to prevent predatory local price cutting and arbitrary buying advantages unrelated to differences in cost. They require no further discussion. Prohibitions of sales below cost are aimed directly at loss leaders. Legislators have shown great ingenuity in devising cost definitions both enforceable and within constitutional limits. The due process clause of the Fourteenth Amendment has been held to outlaw general price fixing and the setting of price minima on the basis of arbitrary cost elements not applicable to each separate economic unit.[16] As a result, the cost floors are generally quite low, and the price cutter must be shown to be acting with intent to destroy or injure competition or competitors. Enforcement of these measures depends in practice on the active co-operation of the independents' trade associations. On the whole, they serve to outlaw extreme temporary price cutting without substantially curtailing the long-run advantages of the more efficient distributors.

RESALE PRICE MAINTENANCE—THE FAIR TRADE ACTS

Legalization of resale price maintenance has been the most notable victory of the independents in the distributive struggle. The economic arguments for and against the practice, which authorizes manufacturers to set the price at which wholesalers and retailers may sell goods carrying their name, have already been reviewed.[17] Its chief pro-

[16] *Fairmont Creamery Co.* v. *Minnesota,* 274 U.S. 1 (1927). See also *Great Atlantic & Pacific Tea Co.* v. *Ervin,* 23 F. Supp. 70 (1938), invalidating the Minnesota Unfair Trade Practices Act. The statute was greatly modified in 1939.

[17] See above, pp. 478–479.

ponents in recent years have been manufacturers and dealers in liquors, drugs, and cosmetics, and book publishers—above all, the independent druggists, organized into a very powerful trade association. Under the Sherman and Federal Trade Commission Acts, the Supreme Court, while reluctant to restrict the right of manufacturers to refuse to deal with traders for any or no reason, consistently forbade explicit price maintenance contracts or their implicit equivalent. Legalization through amendment of the Sherman Act by the so-called Capper-Kelly Bill was defeated in Congress in 1930 by only a narrow margin. The FTC was directed to investigate the merits of legalization in 1929, but its report was adverse. Groups interested in resale price maintenance, therefore, turned to the state legislatures.

A California statute in 1931 authorized voluntary price maintenance contracts between manufacturers and dealers. In 1933 it was extended under the name "Fair Trade Act," now generally applied to this type of legislation, in such a way that the minimum price set in a contract between a manufacturer and a single dealer became binding, after notice, upon all dealers, whether or not parties to the contract. This novel provision greatly improved the bargaining position of an organized group of retailers in forcing maintenance contracts upon recalcitrant manufacturers and made them binding willy-nilly on cut-rate stores and mass distributors. Its clear disharmony with common-law principles of contract led to constitutional doubts; a corresponding New York statute was invalidated by the highest court of that state in 1936.[18] Later in that year, however, the Supreme Court sustained the provision, when limited to branded or trademarked commodities, as a legitimate means of protection to manufacturers' good will.[19] A wave of Fair Trade Acts then swept the country, until in 1940 only Delaware, Missouri, Texas, Vermont, and the District of Columbia were lacking them. In Delaware and Vermont voluntary contracts were authorized, but they were not binding on noncontractors.

Well-nigh nation-wide approval of resale price maintenance by the states still left commodities dealt with in interstate commerce subject to the limitations of the federal antitrust laws. Administration policy throughout the NIRA period forbade the explicit authorization of price maintenance in NRA codes. Its advocates sought to remedy this situation by the Miller-Tydings Amendment to the Sherman Act,

[18] *Doubleday, Doran and Co.* v. *R. H. Macy and Co.*, 269 N.Y. 272 (1936).

[19] *Old Dearborn Distributing Co.* v. *Seagram-Distillers Corp.*, 299 U.S. 183 (1936).

authorizing maintenance for interstate commerce in those states where it was permitted by state law. Politically, this approach had the advantage of appearing to cater to the desires of the individual states rather than directly attacking the almost sacred text of the Sherman Act. The move was temporarily delayed by the stated objections of President Roosevelt and the FTC, but Congress was ultimately persuaded to enact the amendment as a "rider" to the District of Columbia Appropriations Act in 1937. It was signed by the President with some misgiving, accompanied by caustic criticism of the practice of attaching irrelevant "riders" to urgent general legislation. The Administration's objections had been met, in part, by a proviso prohibiting *horizontal* price agreements between manufacturers, or between wholesalers, or between retailers, or between other competitors.

Resale price maintenance has, therefore, now become part of general trade regulation policy. Only a few detailed inquiries into its effects have been made.[20] Maintenance contracts have been adopted very widely by drug, cosmetic, and cigar manufacturers, and by book publishers, to a lesser extent in the liquor trade, and only rarely in groceries, hardware, stationery, cigarettes, or other lines frequently used as loss leaders. On price-fixed articles, the minimum price tends to become universalized at a level considerably higher than that previously found in metropolitan chain and cut-rate stores, but somewhat lower than previous prices in "neighborhood" and country stores. Retail druggists, the most enthusiastic supporters of the practice, are in a position to spread its adoption by concerted refusal to "push" sales of unfixed articles.

The practice has monopolistic implications of two sorts. Although horizontal price agreements are still forbidden, the simultaneous pressure of organized retailers on all manufacturers in a given line may result in higher prices (and in higher retailers' margins) as effectively as a direct price agreement among manufacturers. To some extent, this process is limited by the competition of substitutes, especially of private brands sold by the mass distributors. But the compelling attractions of modern advertising can maintain a surprisingly large differential in favor of commodities carrying nationally known names even where physical quality is identical. In the second place,

[20] In 1939, the FTC began a new study of resale price maintenance in an effort to appraise the effects of "Fair Trade" legislation. At the end of 1940, the Commission had not yet made its report.

price maintenance reduces competition in distributive methods. Consumers may not choose to sacrifice superior store location, quick service, credit, delivery, and return privileges in exchange for lower retail prices. The more efficient distributors, while they may pocket a larger profit than the less efficient, cannot use the appeal of lower prices to expand at their expense. Thus, price maintenance discourages improved efficiency in the distributive mechanism, which is generally supposed to have lagged far behind improvements in production. The legislation goes well beyond the elimination of loss leaders, in the name of which its justification is frequently argued, for it also forbids prices to reflect any variations in distributive efficiency or in nonprice services.

CHAIN STORE TAXATION

Potentially the most effective type of attack on mass distribution is direct, discriminatory taxation. Unlike the alternative attacks, it is not put forward as designed to equalize opportunities by depriving the chains of unwarranted advantages or denying to them the use of unethical competitive methods. It generally attacks chain store merchandising as a socially undesirable phenomenon, to be discouraged, and if possible eliminated, in pursuance of the states' police powers. The movement began in 1927 in Georgia, Maryland, and North Carolina, and by 1939 had spread to twenty-eight states. A California tax law was repealed by popular referendum, after an extremely bitter contest. In a few instances the laws are merely for revenue, but for the most part they are clearly punitive. Generally, the tax per store is increased with the total number of stores in the chain, thus weighing heavily on larger chains. A Louisiana law of 1934 imposed a tax on each store within the state ranging from $10 for chains of ten or less, up to $550 for chains of more than five hundred, the number of stores on which the tax *rate* was based including those outside the state. Pleas of unconstitutionality have been of no avail. The Supreme Court, over the dissent of its more conservative wing, has upheld the separate classification of chains for tax purposes, not only as warranted by their economic advantages, but as a permissible exercise of social policy. Thus, in upholding the Louisiana statute, it said:

> If, in the interest of the people of the state, the legislature deemed it necessary either to mitigate evils of competition as between single stores

and chains or to neutralize disadvantages of small chains in their competition with larger ones, or to discourage merchandising within the state by chains grown so large as to become a menace to the general welfare, it was at liberty to regulate the matter directly or to resort to the type of taxation evidenced by the Act of 1934 as a means of regulation.[21]

Chain store tax laws have not yet substantially reduced the proportion of retail business done through chains, which is slightly under 25 per cent. The chains have, however, tended to abandon a number of country and smaller city units, concentrating on shopping centers where large turnover can support this added cost. A prohibitory federal tax has been proposed by Representative Patman, the leading Congressional opponent of the chains. It would impose a tax per store ranging from $50 for chains of ten to fifteen, up to $5,000 for chains of over five hundred stores, with the tax then multiplied by the number of states in which the chain operates. Unless a successful technique of evasion were devised, through a holding company arrangement or otherwise, such a law would spell the end of the large chain in the American economy. The chains have publicly declared their intention of fighting the measure through a large-scale campaign of publicity.

PHILOSOPHY OF THE ATTACK

The legislation here reviewed is not inherently in harmony with general antitrust policy. Although frequently defended as a means of forestalling "monopolization" of distribution by mass distributors, the decline in their relative growth and intense competition among themselves make the bogey of monopoly in this field appear very unreal indeed. These measures are rather in the category of governmental promotion of a special interest, the interest of wholesalers and retailers of the traditional distributive hierarchy, by impeding the operation of effective competitors regardless of their relative economic merits. The justification in terms of general interest is sought on broad social and political, rather than economic, grounds. Thus, it is argued that the maintenance of an independent middle class is vital to a

[21] *Great Atlantic & Pacific Tea Co.* v. *Grosjean,* 301 U.S. 412, 426–427 (1937). See also *Tax Commissioners* v. *Jackson,* 283 U.S. 527 (1931); *Fox* v. *Standard Oil Co.,* 294 U.S. 87 (1935). In *Liggett Co.* v. *Lee,* 288 U.S. 517 (1933), the Court invalidated a tax which was increased if the chain had stores in more than one county. The case is notable for a long dissent by Justice Brandeis setting forth his views on the social dangers of concentrated economic power.

healthy democracy, and that opportunity should be preserved for small enterprise even at the sacrifice of some degree of efficiency. Independent merchants are said to constitute more desirable citizens, especially in local civic affairs, than chain store managers. Low chain store wages and exploitation of labor are also attacked.

These latter abuses, in so far as they exist, might be met by direct legislative regulation. It may also be suggested that alternative roads of self-defense lie open to the independents, through the organization of "voluntary chains" for co-operative purchasing and advertising. This movement has made notable headway in recent years. How far special support should be given to the class of independents at the expense of improved distributive methods is, of course, ultimately a matter for decision by the electorate. That legislatures have gone so far in this direction during the last decade is a tribute to the effectiveness of organized pressures under our political order.

4. The Revival of Antitrust Policy

For a short period after the death of the NIRA, no further effort of note was made to reconsider antitrust policy in general terms. Accepting the old law as settled policy for the time being, the Department of Justice began to consider possible means for improving its enforcement. The head of the Antitrust Division proposed establishment of an economic unit to enable the Department to investigate possible violations without awaiting complaint from private parties. In the spring of 1937, the Attorney General commented on the inadequate means of enforcement "in the face of a present tendency to increase prices," and asked for a special commission to study the law with a view to amendment, extension, and clarification. Tentative explorations were begun, through public hearings on a bill sponsored by Senators Borah of Idaho and O'Mahoney of Wyoming, on the possibility of requiring federal licenses for corporations of substantial size engaged in, or closely affecting, interstate commerce. License restrictions would be used both to safeguard investors and to supply government agencies with requisite information for regulatory purposes. The proposal had been seriously considered during the Taft Administration, and had been supported subsequently by a number of students of the trust problem. The antitrust laws would be given new teeth—sharpened beyond recognition—through suspension of the license for flagrant violations.

These cautious gropings toward a revived antitrust policy were given violent impetus by the precipitous recession of 1937. Starting at 118 in May of that year, the Federal Reserve index of industrial production fell during the next twelve months to 76, a drop of 36 per cent. The recession was attributed by the Administration to two major causes: unwillingness of private investors to replace the declining flow of government spending, in the face of labor unrest and a supposedly hostile President and Congress; and, secondly, monopolistically induced price rigidities and price increases, particularly in the heavy industries and in building materials, which were supposed to have prevented increased purchasing power from being adequately reflected in increased demand. The second hypothesis led directly to proposals for a new campaign of antitrust law enforcement. It was strengthened, in the government's view, by the recurrent phenomenon of identical bids on government contracts.

ANTITRUST DIVISION REDIVIVUS

The new campaign was conducted simultaneously on two fronts. One, directed toward longer run objectives, involved a broad investigation of the structure of the present American industrial order, with an eye toward a renovated trade regulation policy. The other sought more immediate objectives through an unprecedented "trust-busting" effort within the framework of existing, or only slightly modified, statutes. Doubtless the recently demonstrated willingness of the Supreme Court to review constitutional provisions in the light of changed conditions inspired hopes of a similar freshness of judicial attitude toward the Sherman Act. This latter move was signalized by the appointment, first, of Robert H. Jackson and, in 1938, of Thurman Arnold, as Assistant Attorney General in charge of the Antitrust Division of the Department of Justice.

The revivified Division has repeatedly emphasized its conviction that antitrust policy is directly relevant to the partial stagnation of the economic system, that the law has been hampered in the past both by unfavorable judicial interpretation and by inadequate executive efforts at enforcement, and that more vigorous enforcement must be attempted. It sought, therefore, to obtain appropriations for larger personnel, to select for prosecution cases involving economically important industries where monopolistic conditions were supposed to be substantially impeding recovery, and to employ the most effective remedial techniques from among the alternatives offered by the law.

Appropriations had averaged around $200,000 for many years; in 1937–38 they were $440,000. Yet the preparation and trial of a single important case, like the recent criminal prosecution of Midwestern oil companies, costs the government as much as $175,000. Under those conditions, law enforcement could be little more than occasional and scattered sniping at important offenders. Assistant Attorney General Arnold could claim with justice that, despite the fulsome lip service paid it for half a century, the Sherman Act had never been given a fair trial.

With full administration backing, appropriations were raised to $780,000 in 1938–39 and $1,325,000 in 1939–40 and 1940–41. This increase in funds afforded antitrust law officers an entirely novel breadth of action.[22] From a few dozen lawyers the staff was enlarged to about 250. A large number of attorneys and economists could now be detailed to make a comprehensive investigation of an entire industry, seeking the focal points of price and output policy formation and laying the groundwork for formal attacks through the courts. This technique was used in preparation for antitrust actions in the fertilizer, milk distribution, building materials, and wholesale foods industries, and in examining a new but highly effective type of trade association control through "management engineering" firms.

The Division has also re-examined the effectiveness of existing legal remedies. It has classified illegal situations into a group suited for "prevention" and a group where monopolistic conditions so pervade the market that the only possible solution is a "cure." For the former, the criminal provisions of the Sherman Act are employed almost exclusively, on the ground that the present sanctions of injunction proceedings are an insufficient stimulus to observance of the law. For the latter group, however, the Division has announced a policy of seeking "constructive economic solutions," wherever possible through a greatly extended use of the consent decree.

Unlike the earlier practice of advance approval of proposed business contracts or agreements, which Assistant Attorney General Arnold has emphatically rejected, the consent decree technique provides for an agreed disposition of a specific case, with judicial sanction and equitable remedies for noncompliance, and provision for occasional review of the settlement to determine its effectiveness in

[22] The Antitrust Division was enabled by its increased appropriations to institute 92 cases and 215 major investigations in 1939–40, as against 1937–38 figures of 11 and 59, respectively.

practice. It was applied in 1939 in connection with automobile finance companies associated with Ford and Chrysler, and in 1940 in the suit against the "Big Eight" motion-picture producer-distributors.[23] In addition, the government has for the first time sued for triple damages on its own account, in a proceeding against the major automobile-tire manufacturers arising out of identical bids on public contracts. The Antitrust Division has attracted public attention to its work by issuing explanatory statements at the commencement and disposition of each major suit, and by a series of radio addresses and newspaper articles.

The most significant innovation of the new program is the broadened use of the consent decree. The Antitrust Division has described its use as "a method of giving approval to voluntary plans or practices which are essential for efficient production and distribution of goods." Furthermore:

> Any such plan must meet the following four requirements: first, it must be addressed to the problems of a particular industry; second, it must be given for a limited period and subject to constant check; third, there must be machinery to penalize the abuse of the position created by such approval; and fourth, that approval must be in a form which will permit ready reference to Congress, in order that the policy of the Department may be under constant scrutiny. Such approval can only be given by judicial decree in a civil proceeding which may be used concurrently with a criminal prosecution. The limitations on using these proceedings concurrently [are] as follows:
>
> a. The proposal for a consent decree must be voluntary, which means that the Department will in no instance start negotiations or suggest compromises on the basis of which prosecution would be dropped.
>
> b. It will not compromise criminal cases on the mere promise to reform. It will accept only proposals which will establish competitive conditions on a more certain and secure basis than might be achieved by further prosecution.
>
> c. It will submit all such proposals to an impartial judicial tribunal and thus be guided by the judgment of the court before it takes final action.
>
> d. It will issue a public statement giving the reasons for its action.
>
> e. At all times, the test of whether a consent decree should be accepted must be whether it will benefit the public, not whether it will give relief to the Department. Only where it appears that the consent decree will yield more constructive results for the consuming public, for employees,

[23] For a summary of the provisions of the motion-picture consent decree, see above, p. 540.

and for competitors, than the eventual criminal punishment of the offenders, will proposals for such a decree be entertained.[24]

The use of the consent decree for "constructive economic solutions" of monopolistic industry situations goes beyond the traditional scope of antitrust policy. For such solutions aim not so much at restoration of competition itself as at consciously forced adoption of commercial policies like those which would be engendered if competition were possible. The Antitrust Division, armed with so strong a statute that businessmen will only rarely risk its violation, is to serve as a watchdog and bargaining agent for the public's interest in policies of low price and high output. As the motion-picture decree indicates, such a policy may on occasion be pursued more readily through continuing administrative supervision of a semicartelized industry subjected to specific limitations than through outright destruction of the cartel.

The question must seriously be raised whether the Antitrust Division in its present form has either the political stability, the approach, or the properly trained personnel to perform this function without the help of a clarified law and supplementary administrative machinery, save on a very temporary basis. Business interests are comprehensibly desirous of more certainty than is afforded by the rule of reason. They are troubled by the breadth of administrative discretion now lodged in the Division. The concurrent use of criminal and civil procedures has been criticized in some quarters as a form of unwarranted compulsion into the acceptance of consent decrees.[25] While the new procedure promises far more concrete results than the older methods of antitrust prosecution, its maximum effectiveness and acceptability would appear to require more systematic administrative forms and procedures specially adapted to its objectives.[26]

Although any general statutory revision will await the final report

[24] *Annual Report of the Attorney General*, 1939, p. 41.

[25] For comprehensive discussion of this and other issues raised by the extended use of the consent decree, see M. Katz, "Consent Decrees and Antitrust Administration," 53 *Harvard Law Review* 415–447 (January, 1940), and M. S. Isenbergh and S. J. Rubin, "Antitrust Enforcement through Consent Decrees," 53 *Harvard Law Review* 386–414 (January, 1940).

[26] A possible line of approach toward such reconstruction of the administrative machinery for trade regulation is suggested in a Temporary National Economic Committee study on *Antitrust in Action*. The authors propose a substantial extension of administrative regulation in the antitrust field. They would separate the policing function from that of negotiating industrial reorganizations, placing the latter duty with an independent agency outside the Department of Justice. Distinct agency sub-

of the Temporary National Economic Committee, the Division has already recommended through the Committee a strengthening of the civil remedies under the antitrust laws. A bill to this effect, sponsored by the Committee's Chairman, Senator O'Mahoney, was introduced into Congress toward the end of the 1939 session.[27] It would make responsible officers and directors of corporations both civilly and criminally liable for offenses, along with the corporations themselves. They would be subjected to civil penalties of twice their monthly salary for each month of violation and might also be enjoined from serving the corporation or any competitor for upwards of three months, perhaps permanently. A corresponding liability of twice its monthly net income for each month of violation would be placed on the corporation. Such teeth in the law, if seriously applied in a few cases, would undoubtedly be a most effective deterrent to violation or even to actions remotely approaching violation. The proposal has called forth sharp opposition. Harsh punishment, it is said, should not be visited upon businessmen in pursuance of a statute which still requires an immense volume of judicial interpretation before an honest, law-abiding citizen can know its precise meaning. The bill was not pressed in its original form, and a measure of this type is very unlikely to become law without substantial modification.

Success for the new policy will depend upon several factors. It bids fair to arouse the hostility of powerful business groups. The Division's attacks on building trade-unions, along with contractors and manufacturers, have antagonized important sections of organized labor and met with partial reversals in the courts.[28] How far the forces of smaller business can be marshaled behind the program is as yet uncertain. Consumers' organizations are still feeble. The whole structure of policy depends upon judicial sympathy. While the Supreme Court's

divisions would be created for the separate tasks of industrial analysis and the formulation of rulings and decrees. The agency would "engage in a constant oversight of the decrees which it has to administer." Judicial review would be taken out of the hands of the ordinary federal courts and concentrated in a special industrial court of five or seven members. "In time there would emerge a 'code industrial' possessed of such focus, breadth, and consistency as human nature and the changing circumstances allow. It would constitute a flexible law of industry for an economy which is on the march." Temporary National Economic Committee, Monograph No. 16, *Antitrust in Action*, by Walton Hamilton and Irene Till (1940), p. 115. Publication of this monograph by the Committee does not imply TNEC endorsement of its recommendations.

27 S. 2719, 76th Cong., 1st Sess.

28 See above, pp. 157–158.

recent decisions in the loose agreement cases manifest a disposition to uphold vigorous antitrust law enforcement, the courts have yet to be converted in a close consolidation case to the view that undesirable economic results, rather than immoral intentions, should be the test of illegality. The maintenance of essential public and Congressional support will depend upon demonstrated success in stimulating and maintaining economic revival. Antitrust policy, finally, has yet to find its appropriate place in the unprecedented national defense effort begun in the spring of 1940.

THE TEMPORARY NATIONAL ECONOMIC COMMITTEE

Contemporaneously with the heightened activity of the Antitrust Division, a far-reaching inquiry has been started under Congressional authority into the extent and consequences of concentrated economic power. Repeated proposals for such an investigation had been forthcoming from both official and private sources ever since the end of the NIRA. Its immediate occasion, however, was the persistent downward trend of economic activity in 1937–38. In a special message to Congress on April 29, 1938, President Roosevelt stated in vigorous terms his conviction that concentrated economic power was a basic factor in America's economic sickness. Thus:

> Among us today a concentration of private power without equal in history is growing.
>
> This concentration is seriously impairing the economic effectiveness of private enterprise as a way of providing employment for labor and capital and as a way of assuring a more equitable distribution of income and earnings among the people of the Nation as a whole. . . .
>
> Private enterprise is ceasing to be free enterprise and is becoming a cluster of private collectivisms; masking itself as a system of free enterprise after the American model, it is in fact becoming a concealed cartel system after the European model. . . .
>
> Interlocking financial controls have taken from American business much of its traditional virility, independence, adaptability, and daring—without compensating advantages. They have not given the stability they promised.
>
> Business enterprise needs new vitality and the flexibility that comes from the diversified efforts, independent judgments, and vibrant energies of thousands upon thousands of independent businessmen. . . .
>
> One of the primary causes of our present difficulties lies in the disappearance of price competition in many industrial fields, particularly in

basic manufacture where concentrated economic power is most evident —and where rigid prices and fluctuating pay rolls are general.

Managed industrial prices mean fewer jobs. It is no accident that in industries like cement and steel where prices have remained firm in the face of a falling demand pay rolls have shrunk as much as 40 and 50 per cent in recent months. Nor is it mere chance that in most competitive industries where prices adjust themselves quickly to falling demand, pay rolls and employment have been far better maintained. By prices we mean, of course, the prices of the finished articles and not the wages paid to workers. . . .

If private enterprise left to its own devices becomes half-regimented and half-competitive, half-slave and half-free, as it is today, it obviously cannot adjust itself to meet the needs and the demands of the country.

He recommended a comprehensive study of the existing economic structure by the executive agencies concerned. Congress soon afterwards granted $500,000 for the investigation and later increased the sum to over $1,000,000. It provided for a Temporary National Economic Committee (TNEC) of twelve members, three from each House, and one each from the Departments of Justice, Treasury, Labor, and Commerce, the Securities and Exchange Commission, and the FTC. Its terms of reference were as follows:

(a) To make a full and complete study and investigation with respect to the matters referred to in the President's message of April 29, 1938, on monopoly and the concentration of economic power in and financial control over production and distribution of goods and services and to hear and receive evidence thereon, with a view to determining, but without limitation: (1) the causes of such concentration and control and their effect upon competition; (2) the effect of the existing price system and the price policies of industry upon the general level of trade, upon employment, upon long-term profits, and upon consumption; and (3) the effect of existing tax, patent, and other Government policies upon competition, price levels, unemployment, profits, and consumption; and shall investigate the subject of governmental adjustment of the purchasing power of the dollar so as to attain 1926 commodity price levels; and

(b) To make recommendation to Congress with respect to legislation upon the foregoing subjects, including the improvement of antitrust policy and procedure and the establishment of national standards for corporations engaged in commerce among the States and with foreign nations.

The TNEC was the first body of its kind since the Industrial Commission of 1898. Its personnel and approach favored antitrust policy

as the basically sound attitude of American government toward the industrial order. Nevertheless, it carefully eschewed any appearance of a moral trust-busting crusade. It stressed the value of fact finding as a basis for policy formation. It refused to commit itself in advance to a given solution, but evidently accepted as a major premise the desirability of the maximum freedom of private enterprise and individual opportunity compatible with the full use of economic resources and a reasonable standard of living. The bulk of the work of investigation was carried on by special staffs attached to the executive agencies represented on the Committee. Thus, the Commerce Department studied the general industrial structure, the effects of business taxation, and trade associations; the FTC dealt with methods of competition, restraints of trade, and the feasibility of federal licensing of corporations; the Treasury Department was concerned with pricing under government contracts; the SEC with the concentration of economic power through financial controls, including banks and insurance companies, and with holding companies and internal corporate structures; the Labor Department (through the Bureau of Labor Statistics) with price policies and problems of labor costs; and the Justice Department with monopolistic practices and the relationship of patent and antitrust policies. The Committee and its agents were given full powers to compel testimony and the production of documentary evidence. The material gathered by the cooperating agencies is being summarized in a series of published monographs. In addition, the more dramatic evidence was presented from time to time to the full Committee in public hearings, through formal examination of witnesses. The hearings were designed primarily to educate the public and to lay a foundation for public approval of the Committee's ultimate recommendations, rather than to elicit new information. They succeeded in attracting wide notice and comment.

In its preliminary report,[29] submitted in July, 1939, the TNEC confined itself to a limited number of recommendations. It supported proposals of the Commerce Department for improvement in the mechanics of the patent system, most of which were, in fact, enacted into law in 1939. It likewise approved proposals of the Department of Justice to limit patent privileges in conflict with antitrust policy by forbidding restrictive conditions in patent licenses. A further recom-

[29] The final report was to be submitted in 1941.

mendation would discourage harassing infringement litigation not begun in good faith. The Committee also sponsored additional civil remedies under the antitrust laws on the lines described above. And it gave its support to the oft-repeated request of the FTC for extension of Section seven of the Clayton Act to forbid intercorporate acquisitions of assets as well as of stock, as a method of effecting monopolistic mergers.

That the Committee's general philosophy favored a reinvigorated antitrust policy is clearly shown by its brief general conclusions. They deserve quotation in full:

> The tendency toward the concentration of control of the economic system in fewer and fewer business executives seems proved.
>
> The consequence of that tendency is a steadily lessening number of competitors.
>
> It has been the traditional conviction of the people of the United States that the opportunity of the citizen to engage in business should not be restricted and that a system of free and open competition is best calculated to preserve that opportunity.
>
> It is clear, however, that the financial and other resources required for economic endeavor are becoming increasingly difficult for the ordinary enterpriser to obtain and that concentration of economic power and wealth is accompanied by increasing unemployment and narrowing markets.
>
> The studies of the committee will be pursued in the hope of discovering the measures which will offer broader markets, more employment, and freer opportunities for the people of America.

5. The Alternatives of Policy

American trade regulation policy has undergone striking changes in its half century of development. Its course is marked by four distinct phases. The Sherman Act of 1890 was a vaguely conceived, direct attack on large, dominating business concerns. It was ineffective. The legislation of 1914 sought to maintain an open door of opportunity for the little businessman by outlawing unfair methods of competition which were thought to be his main obstacle. It was likewise ineffective, not merely because of unsympathetic judicial construction, but also because its assumptions were fundamentally erroneous. The concentration of economic power was not caused solely by the use of immoral, predatory business tactics. In the NIRA, the antitrust laws were relaxed in favor of industrial "self-government." The experiment was made under the most difficult possible condi-

tions, economic and administrative, and its unhappy results were due as much to administrative haste as to faults of policy. Yet the lessons of that period make similar experiments on a large scale very unlikely in any visible future. Since 1937, finally, we have had a revival of antitrust policy on a new basis, unprecedented both in methods and objectives.

For that policy is no longer envisaged solely as a means of protection for competitors and consumers from the exploitation of predatory monopolists. It has gone beyond the phase of government regulation among immediately affected interest groups. It is now directly affixed to that axis on which all domestic policy has turned for a decade—the effective operation of the entire economic order. The "trust problem" is no longer a peripheral pathological phenomenon on the fringes of a seemingly healthy organism; it has become a problem of the capacity of an industrial system to make full use of its human and material resources. By its contribution to the solution of that problem all future trade regulation policy will be measured.

What, then, are the present alternatives of policy in this field? At the extremes are two diametrically opposed programs, both positing a great increase in the role of government. They are atomization of industry into small, highly competitive units, on the one hand, and all inclusive economic planning on the other. The former is by now hardly possible and probably undesirable. In many industries the techniques and economies of mass production make concentration in a few large units inevitable. That process is irreversible. Moreover, apart from the objective physical difficulties of a program of atomization, the strength of political force against the consequent dislocations could hardly be resisted. A planned economy is perhaps possible, but it would necessitate either outright socialization of a large sector of the economy, or, in any case, so wide an extension of public controls over commercial and industrial policy as to reduce the concept of private property in this area to near meaninglessness. No politically influential group in this country favors such a program; it could be adopted only in the wake of political revolution or of far more unambiguous compulsions than are now operative.

A third program would abandon antitrust policy except as a means of eliminating predatory practices universally recognized as objectionable, and would substitute nothing in its place. Such a program might be combined with efforts to show to large concerns, without coercive sanctions, that their own best interests lie in stimulating in-

creased consumption through promotional low-price policies.[30] Experience at home and abroad gives little hope for effectiveness of such a policy. The trend toward cartelization would be accelerated. A large section of the business community would almost certainly seek "stabilization" of prices regardless of demand and of unemployment, and new pressures for government intervention would be called forth. This program would mean merely postponement of policy rather than decision. Yet it is not a wholly unlikely event. Political reaction against the revivified antitrust law, coupled with a general desire to experiment with business "appeasement" as a psychological spur to private investment, may well lead to temporary abandonment of any trade regulation policy. The TNEC investigation would then repeat the history of the Industrial Commission, amassing important and valuable information as a basis for the reformulation of policy, only to have it lie unused until obsolescence makes it unusable.

Another, and apparently more feasible, alternative would begin with a reclassification of industry. Our tradition divides the field into public utilities, demanding regulation of prices, investment, and marketing methods; and the rest, demanding enforcement of competition. Troubles of the soft coal and petroleum industries in recent years have led to the gradual recognition of a third category of natural resource industries, where the wastes of excessive competition injure not only entrepreneurs, workers, and local communities, but also an underlying public interest in conservation. At least two further broad categories stand out, with innumerable gradations. In a large portion of commerce and industry where capital needs are slight, entrance to and exit from the field is easy, and firms are numerous, competition may be enforced through a more vigorous application of the traditional methods. The basic objective there need be simply that of preserving free opportunity to compete. But there is another large industrial sector where none of those conditions applies, and where competition has generally proved most evanescent. In this area the risks of cutthroat competition are so enormous, and the gains from restrictions on competition so palpable, that elimination of one restraining device can hardly be accomplished before another has arisen to replace it. Nor would the results of unlimited competition be wholly desirable, as experience in cotton textiles and bituminous coal indicates. These facts ought occasion no surprise; they arise directly

[30] This is the essence of the proposals in E. G. Nourse and H. B. Drury, *Industrial Price Policies and Economic Progress* (1938).

from the long-recognized, basic motivations of economic enterprise.

In this portion of the economy lie the most difficult problems of policy and the greatest needs for experimentation with new regulatory devices. Competition in the classical sense is impossible here; an approach to it is as likely to lead to economic chaos as to the prices and production theoretically following from a competitive market. Some form of government influence upon, or participation in, the formation of price and output policy appears inescapable. The new use of consent decrees under the Sherman Act, as indicated above, is an implicit recognition of this principle. Further exploration of criteria for such policies, and of administrative machinery for their enforcement, is perhaps the most valuable result to be sought from the TNEC study.

Possible supplementary techniques of regulation are numerous and would vary from industry to industry. They might include further use of the regulatory administrative commission; pressure from the government in its role as large consumer on industries bidding for public contracts; closer regulation of internal corporate structures, including increased publicity, possibly with government representation on strategic boards of directors and advisory representation of interests directly concerned; establishment of an adequately financed Consumers' Department under a Cabinet Secretary, to serve as a pressure group on behalf of this little-organized constituency; encouragement of consumers' co-operatives as a factor favoring increased production and lower prices; and perhaps in some cases establishment of a competitive "yardstick" through direct public enterprise. Demonstrated success should in due course evoke the voluntary co-operation of directly affected business, as well as other groups. Co-ordinating machinery, designed to harmonize the separate elements of trade regulation policy with one another and with the remainder of government efforts at economic stabilization, would also evidently be required.

Like recent developments in public utility regulation, such a program views trade regulation as consciously directed toward national ends—in particular toward an enlarged national income. This attitude is a significant departure from the earlier antitrust tradition. It is engendered by a process which seems irreversible except for the briefest of periods—extension of governmental activity commensurate with the responsibilities with which government is in fact charged by its citizens. Experimentation along these lines appears to offer substantial promise of success coupled with the least dislocation of our economic and political traditions.

Chapter Seventeen. NEW EXPERIMENTS IN INDUSTRIAL CONTROL: OIL AND COAL

Regulatory action in the industrial sector of the American economy falls almost entirely into the categories of public utility or antitrust policy. The oil and coal industries, however, are in a class apart. Here extensive government intervention, focused around production control in the former instance and price control in the latter, has been undertaken primarily in response to pressures from producers. Demands for government action and the resultant regulatory techniques are peculiarly conditioned by the respective technologies of production. The rationale for public regulation, moreover, adds to the factors common to other industries the underlying interest of the public in the conservation of the nation's two most vital energy resources.

1. Regulation of the Oil Industry

In one phase or another, the oil industry has occupied the attention of government for over sixty years. Concentrated control of refineries and pipe lines played a leading part in producing the antimonopoly movement. Attempts were made successively by the states and the federal government to break up refining monopolies through antitrust prosecutions. Pipe lines were given public utility status and placed under the Interstate Commerce Commission's control in 1906. Dissolution of the Standard Oil trust in 1911, however, failed to provide a permanent solution for the monopoly problem in refining and distribution. A single near monopoly was replaced by a series of major concerns exercising a dominant influence over these portions of the

industry.[1] Concerted price control efforts among the "majors" remain one of the most baffling problems facing antitrust law enforcement. Recent manifestations of the perennial struggle between the Department of Justice and the oil industry have been discussed in Chapter 15.

Our concern here is with a different sector of the industry—the production of crude oil.[2] In this sector concentration of control is far less marked. In the pre-World War period, discoveries and production were kept up with the expanding demand through "wildcat" drilling by thousands of individual explorers. More recently, intricate geophysical and geological exploratory techniques have come to the fore. Far more successful than "wildcatting," they require heavy capital investment and are necessarily open to use only by large concerns. In order to assure themselves of ample supplies of crude oil, therefore, refiners have tended to an increasing degree to extend their operations back into production. Nevertheless, although the twenty "majors" are now responsible for slightly over half of the total crude oil supply, the independent remains a potent factor. He is a powerful force in the politics of the oil states. The sprinkling of every major oil field with the small holdings of independent producers is one fundamental determinant of the modern regulatory system.

The regulatory pattern for oil production is a blend of three elements. (1) Direct production control is imposed by most of the oil states through proration laws. (2) A degree of interstate collaboration is provided by an interstate oil compact. (3) State regulation is supplemented by federal assistance (a) in determining production quotas and (b) in forbidding interstate shipments of oil or petroleum products produced in violation of state law. In recent years, significant steps have been undertaken looking toward more extensive federal

[1] The twenty major integrated oil companies own over three quarters of the nation's crude oil refining capacity, over 85 per cent of the "cracking" plant refining capacity, over 72 per cent of the crude oil pipe line mileage, and over 96 per cent of the gasoline pipe line mileage. Their production of gasoline, by far the most important petroleum product, is about 84 per cent of the total.

For more detailed statistical material on the petroleum industry see Temporary National Economic Committee *Hearings on Investigation of Concentration of Economic Power,* 76th Cong., 2nd Sess., 1939, Part 14-A.

[2] Natural gas is usually, but not always, produced in conjunction with oil. It plays a vital role in oil recovery, as is indicated below. Regulatory measures deal with both oil and gas jointly, but each of the two products presents separate problems as well. Owing to limitations of space, the regulation of the natural gas industry as such is not treated in the present chapter.

regulation. Before discussing these developments, it is essential to consider the technological and economic factors motivating the imposition of public controls.

THE BASIS FOR GOVERNMENT INTERVENTION

The need for "conservation" is invariably placed at the forefront of arguments for special public interest in the production of oil. No precise meaning can be given to this term in its application to the oil industry. At one extreme is a concept demanding postponement of consumption and active discouragement of "lower uses," particularly those for which more abundant substitutes are readily available. At the other is a definition including merely the avoidance of obvious overground waste caused by burning, running off into the ground, or uncontrolled blowing off of gas. The peculiar technology of oil production, however, provides between these extremes a broad zone within which the contemporary conservation movement operates. Scientific research in recent years indicates that the proportion of crude oil recovered from below ground depends, in large measure, upon the methods of recovery. Moreover, conservational techniques promoting greater ultimate recovery are, in the long run, less costly to the producers themselves. They depend for their effectuation, however, upon co-operative action by all the well owners in a given field. For the accomplishment of this purpose public control has proved essential.

Common-law rules governing the rights of surface owners and leaseholders, as they developed in this country after the discovery of oil in 1859, not only failed to promote conservation but actively encouraged waste. Ownership of land overlying an oil pool is ordinarily divided into numerous holdings unrelated to the subsurface petroliferous structure. The liquid oil is held in suspension in porous sands through a complex physical equilibrium of overlying gas pressure, underlying hydrostatic pressure, and peripheral rock pressure. The viscosity of the liquid, and the consequent ease with which it flows to the surface, depends in part upon its chemical constituents and in part upon the proportion of dissolved gas. By far the most economical means of recovery is based upon optimum utilization of the natural reservoir energy. Exploitation based solely on engineering criteria demands careful spacing of wells, drilling to carefully selected depths, and limitation of the relative rates of flow of gas and oil in order to maintain the maximum natural pressure as long as possible.

In areas where entire pools are managed under unified auspices, such as the Iranian fields leased to British interests, these practices are readily followed. Diversity of ownership under American conditions, however, produces far different results.

As a general common-law principle, a landowner holds title to all minerals directly underlying his property. Oil, however, is by its nature fugacious. Release of reservoir pressure through tapping the system at one point induces migration of oil toward that well from the rest of the reservoir. By an unfortunate application of the English legal doctrine concerning underground percolating waters, rights in oil were subjected to the "rule of capture." Under this principle a well owner obtains title to all the oil raised through his well regardless of its original location under the property of his neighbors.

In consequence, no sooner is a discovery well sunk in a given field than every other property holder begins drillings in order to obtain as large a share as possible from the pool. The owner of a large tract will place "offset wells" at frequent points around his boundaries in order to balance the withdrawals of his competitors. The rate of recovery will be as high as reservoir pressure permits, since restriction by any single producer will merely redound to the benefit of others. Such "flush production" exhausts the natural reservoir energy with extreme rapidity. Depending upon the particular geological formation, as little as 10 per cent of the oil may be recovered without pumping, contrasted with up to 50 or 60 per cent under the best engineering practice. Not only does this condition waste capital through excessive drilling and acceleration of the substitution of "stripper well" (i. e., pumping) operations; it may also make large portions of the oil permanently irrecoverable. The unduly rapid escape of gas from solution increases the oil's viscosity and sometimes makes it impossible to pump. In addition, encroaching water may cut off sections of the pool. Thus, the combination of a unique technological situation with diffused surface ownership, together with the rule of capture, necessitates public intervention in order to achieve the objectives of conservation.

The extent of public interest in oil conservation is a function of the relatively low ratio of known reserves to existing production. The most recent estimates of proven reserves vary around 18,000,000,000 barrels, compared with an annual production rate of about 1,300,000,000 barrels. The reserve-production ratio is therefore somewhat less than fourteen years. Thus far, discoveries have more than kept pace with annual production. The reserve-production ratio has thus re-

mained almost constant since the first World War, despite a greatly increased absolute volume of production. On the other hand, new discoveries remain, to a large extent, a matter of chance.

The vital role of petroleum products in our present social and economic structure needs no emphasis. In addition to its automotive, lubricating, and domestic heating uses, it has became essential to the instruments of national defense. The air force, mechanized army units, and naval vessels are alike dependent upon the maintenance of oil supplies in adequate quantities. Manufacture of gasoline from coal is now technically possible, but only at a cost approximately three times that of the natural product. Dependence upon the artificial substitute would create serious dislocations in an economic structure geared to abundant use at present prices. Since the recovery of an increased proportion of known deposits through improved production techniques offers at least as great an augmentation of supplies as probable future discoveries, the public interest in extending conservation can hardly be questioned.

Despite this clear-cut general interest, the needs of conservation alone would probably not have engendered the present regulatory machinery. Active state intervention was induced rather by pressures for economic stabilization and for the protection of correlative individual interests. Like "conservation," the term "stabilization" has no universally accepted meaning. In this context it may be taken as the maintenance of crude oil prices above the total production costs of relatively inefficient producers. Under the conditions peculiar to the oil industry, this objective is directly related to that of conservation. For restrictions on production not only maintain prices by limiting supplies to the demand at a lucrative price level; they may also, if properly administered, bring production techniques into conformity with high engineering standards and thereby increase the total ultimate recovery. In addition, they may prevent the abandonment of "stripper wells" during temporary periods of "flush production" from newly discovered fields. Such abandonments, for technical reasons, often become permanent.

The objectives of conservation and stabilization, while overlapping, are not identical. Their harmony in practice depends, in large measure, upon the particular restrictive measures imposed. The immediate impetus to present control mechanisms undoubtedly came from the desire for stabilization. It arose from the conjunction early in the decade of the thirties of new discoveries on an unprecedented scale,

above all in the extraordinary East Texas field, with an absolute falling off in demand for the first time in the industry's history. Crude oil prices fell in 1931 from nearly one dollar to less than 10 cents a barrel. The situation threatened total demoralization of the industry. Under the spur of this situation, the producing states undertook large-scale restriction for the first time.

THE PATTERN OF STATE REGULATION

Legislative attention was first turned to problems of oil production during the last quarter of the nineteenth century. Pennsylvania and New York led the way in 1878 and 1879 and were soon followed by the other producing states. These early statutes provided minimum safety standards, discouraged the more dramatic forms of overground waste, and protected fields against malpractices by individual well owners.

Production control, together with the concept of "economic waste" (i.e., production beyond market requirements at remunerative prices), was first introduced by Oklahoma in 1915 as a result of temporary oversupply. Wartime demands postponed the practical application of this law. From the close of the first World War until the late twenties, strides in automotive demand were so enormous that more anxiety was expressed over prospective shortages than over excessive production. Only with the sudden wealth of new discoveries between 1926 and 1931, coinciding with a sharp reduction in demand, was outright restriction undertaken. The modern era of state regulation is thus of less than fifteen years' standing.

The producing states had good reason to be concerned over the situation. Their tax revenues depended, in large measure, upon the prosperity of the oil industry, and the depression was saddling new burdens of unemployment relief upon the hard-pressed state treasuries. Producers clamored for public aid. The Oklahoma law of 1915 was therefore revived; Texas followed with similar action. At the height of flush production from newly discovered pools, however, ordinary administrative expedients did not suffice to stem the tide.

Litigation was one obstacle. Although statutory restriction had been sustained in principle for many years, both as a legitimate conservational measure and because it tended to protect correlative rights in particular fields, the particular methods of restriction adopted in the

emergency were struck down under the Fourteenth Amendment. Moreover, while favoring state control as a group, producers as individuals feared the drainage of their oil sands and maintained a hectic race for recovery under the rule of capture. A flood of "hot" (contraband) oil, produced in disregard of restriction laws, flowed from the Texas and Oklahoma fields. The governors of these states even resorted to martial law, policing production controls with the aid of the militia; but this extreme measure was invalidated by the Supreme Court. Stability was finally achieved only in 1933, with the aid of federal intervention under the National Industrial Recovery Act.

Despite the temporary failure of state restriction at the pit of the depression, legislative and administrative techniques devised at that time remain at the heart of the control machinery. All the important producing states, except Illinois and California, follow a similar regulatory pattern, although with significant differences of detail. In California, where the restriction statute of 1931 was repealed in the following year, results of the same type are achieved through voluntary curtailment under a producers' cartel.

The core of the production controls is the system of proration. Proration is simply the allocation to each producer of a maximum production quota, which is ordinarily fixed pro rata to his potential production. Determination of total national production and allocations among the states are made through federal machinery described below. The state problem is one of allocation to individual producers within its boundaries.

In seeking a workable proration plan, administrators are faced with a tangle of technical, economic, and political considerations. Principles of equity, implemented to some extent by judicial application of the Fourteenth Amendment, require that production allowances be distributed as nearly as may be in proportion to the oil in place under each producer's property. Engineering technique has made great strides toward affording a basis for accurate estimation of oil in place, but expert agreement on this matter is still far in the future. If a field's quota is only a small fraction of its potential, a strict prorata distribution will make many of the smaller properties unremunerative. A minimum per well allowance is therefore usually set for such "marginal wells." For the others, one or another formula, combining well depth, acreage of the property, bottom hole pressure, and other technical factors, is applied. Sometimes the quotas are fixed at a given

fraction of the "open flow" rate, which is tested by wide-open production for a limited period.

While proration formulas are expressed in engineering terms, the weighting of the different elements is conditioned largely by the political influence of various producing groups. In a field like East Texas, for example, marginal well allowances absorb a large proportion of the total allowable, so that substantial discrimination is claimed by larger owners. Until recently, all such issues were fought out in the federal courts and administrative action frequently fell by the wayside. In the last two years, however, the Supreme Court, recognizing that proration presents "as thorny a problem as has challenged the wisdom and ingenuity of legislatures," has left its solution to the state administrators.[3]

Whatever the formula applied, proration almost inevitably leads the state into more intensive regulation of productive methods. As long as the single well unit or the open flow rate plays any part in the determination of allowables, an incentive is provided to multiplication of wells. New wells not only waste capital; they also tend to offset most or all of the conservational advantages of restriction. To an increasing extent, therefore, particularly since 1935, states have undertaken drilling restrictions. One type of well spacing law establishes "proration units" of specified acreage, based upon optimum productive efficiency with a single well, regardless of ownership rights in the unit. Owners of individual tracts are given the option of sharing the expense of a single well and dividing its yield in proportion to their acreage, or of drilling themselves, subject to a small proration allowance based upon their land area. Acceptance of "proration unit" pooling is clearly preferable from the viewpoint both of the individual and of the public. In Texas a compromise measure provides a general minimum acreage per well, but gives to the Railroad Commission administrative discretion to grant exceptions in order to avoid individual hardship. The pressure of small-tract owners in the East Texas and Gulf Coast fields has, in fact, been so overwhelming that the average area per well is more nearly five acres than the nominal legal standard of twenty.

In recent years, engineering standards promoting underground conservation have been given increasing weight in the administration of state restriction statutes. Market stabilization undoubtedly remains

[3] *Railroad Commission of Texas* v. *Rowan & Nichols Oil Co.*, 310 U.S. 573 (1940); also 61 S. Ct. 343 (1941).

the guiding motive. This objective, however, is satisfied merely by the decision to restrict production to a given figure. Ample scope remains for the application of conservational criteria, both in the distribution of allowables among individual wells and through the requirement of improved production practices as an incident to state protection of the market. Compulsory pooling is the most promising aspect of this trend. It makes a notable step toward the ideal of unit operation, which alone provides the conditions for optimum exploitation. Compulsory unitization is widely opposed by producers for fear that particular interests will be damaged. Its basic difficulty lies in the equitable apportionment of income from the pooled operations. In fact, however, similar problems are faced in the administration of any proration plan. Technical progress in determining the extent and structure of underground formations makes these problems increasingly capable of objective solution.

The whole fabric of state regulation depends upon interstate co-operation. Unrestrained production in a single state may break down the entire carefully built market structure. Restriction elsewhere will then simply benefit the non-co-operator. The mutuality of interest among producing states has not proved sufficient to hold them all in line without federal aid. This weakness of state regulation was emphasized in 1939 and 1940 by the sudden upswing of Illinois production into a major place in the industry.

INTERSTATE CO-OPERATION AND FEDERAL ASSISTANCE

Federal interest in oil production is more generalized than that of the producing states. As trustees for the nation's defense, federal officials have long been concerned with the possibility of shortage in time of war. In this connection three naval oil reserves have been established as a minimum emergency measure. The Interior Department, through its control of oil leases on public lands, has experimented with conservational techniques, including compulsory pooling and unit operation. Active participation in the general regulatory machinery, however, is, for the most part, a supplement to producer-inspired state regulation. It provides a minimum degree of outside aid without which state controls would become impotent.

In 1924, when an oil shortage appeared imminent, President Coolidge appointed a Federal Oil Conservation Board to investigate productive methods and promote conservation. The situation shifted shortly from shortage to surplusage. The Board turned its attention

to promoting interstate co-operation for production restriction. At its instance, meetings of interested governors were held in 1929 and 1931 in an effort to obtain uniform state action. A degree of success was achieved for a brief period between 1931 and 1932, but it was followed by an even greater demoralization of the industry than before. A number of proposals were made for direct federal control through special legislation, but they were displaced for the moment by action under the National Industrial Recovery Act.

The NIRA affected the industry in two ways. Section 9 authorized the President to prohibit interstate and foreign transportation of petroleum and petroleum products produced or withdrawn from storage in conflict with state law. This power was applied almost immediately and succeeded, by the end of 1934, in putting a stop to the rush of "hot" oil from East Texas. Meanwhile, a petroleum code was adopted in the summer of 1933 under the general provisions of the Act. During the period of its operation the entire regulatory system was transferred to federal hands. Imports were limited; production was restricted to estimated consumer demand at remunerative prices and allocated among states, pools, and individual wells; prices were controlled; and the entire refining and distributing industry was surrounded with a network of complex limitations designed to maintain the price structure.

Unlike that of many other NRA codes, petroleum code administration was not delegated exclusively to industry representatives. It was withdrawn from NRA supervision and placed under Secretary of the Interior Ickes as special Petroleum Administrator. He, in turn, appointed a Petroleum Administrative Board, consisting largely of Interior Department officials, as the chief supervisory agency. The industry was represented by a Planning and Co-ordination Committee. The Administrator viewed this body merely as an advisory committee; its members, however, considered themselves the appropriate instruments of policy formation. The entire history of oil regulation under the NIRA was marked by conflict between the two agencies. On the whole, the industry welcomed termination of the Act by judicial decision in the spring of 1935.

A few months before invalidation of the NRA as a whole, the Supreme Court had vetoed Section 9 as an improper delegation of legislative authority.[4] Immediate steps were taken to replace it by

[4] *Panama Refining Co.* v. *Ryan*, 293 U.S. 388 (1935).

special legislation. The Connally Act, passed in February, 1935, directly forbade interstate commerce in contraband oil and provided appropriate sanctions for enforcement. Protection against abuse of this authority by the producing states was placed within the discretion of the President by Section 4, which read as follows:

> Whenever the President finds that the amount of petroleum and petroleum products moving in interstate commerce is so limited as to be the cause, in whole or in part, of a lack of parity between supply (including imports and reasonable withdrawals from storage) and consumptive demand (including exports and reasonable additions to storage) resulting in an undue burden on or restriction of interstate commerce in petroleum and petroleum products, he shall by proclamation declare such finding, and thereupon the provisions of section 3 shall be inoperative until such time as the President shall find and by proclamation declare that the conditions which gave rise to the suspension of the operation of the provisions of such section no longer exist.

Effective in the first instance for a limited period of two years, the Connally Act was renewed in 1937 and again in 1939. It now extends until June 30, 1942.

Meanwhile, earlier proposals for interstate co-operation were bearing fruit in an interstate compact among the producing states of the mid-continent area. It, too, was limited to two years from 1935, but was subsequently renewed for two-year periods and now expires on September 1, 1941. The ratifying states were Texas, Oklahoma, Kansas, New Mexico, Colorado, and Illinois. Of the large producers, only California remained outside its scope. The states bound themselves to enact within a reasonable time conservation laws based upon sound engineering principles. Article 5 specifically renounced any purpose to "limit the production of oil or gas for the purpose of stabilizing and fixing prices thereof or to create or perpetuate monopoly or to promote regimentation." The compact's purpose was stated positively as "conserving oil and gas and preventing the avoidable waste thereof within reasonable limitations." Administrative machinery was established in the form of an Interstate Oil Compact Commission, including a representative from each state. In practice, although the Compact Commission is a useful instrument for exchange of information, uniform standards of conservation legislation have not resulted from its operation. Moreover, despite the renunciation of stabilization as an objective, it was employed in August, 1939, as a means of agree-

ment for temporary complete shutdown of production in the face of a price cut by one of the major refiners. By and large, however, the compact cannot be viewed as a really effective co-operative device.

The federal government also participates in the machinery of regulation by providing a basis for establishing national production quotas and allocating them among the states. Monthly estimates of demand are made by the Bureau of Mines and converted into production figures. Allocations among the states are made in accordance with established channels of supply to refineries. While state acceptance of these figures for application in their individual proration programs is wholly voluntary, they are, in fact, very closely followed. The possibility of a single state's refusal to maintain co-operation, however, exemplified by the action of Illinois in 1939, remains a threat to the effectiveness of the entire apparatus of control.

PROPOSALS FOR INCREASED FEDERAL REGULATION

The existing degree of federal participation in the regulation of oil production gives support to state measures regardless of their contents. Limited protection is provided by Section 4 of the Connally Act, quoted above, against extreme curtailment by the states in an endeavor to obtain monopoly profits. This remedy is capable of use only in an extreme emergency, however, and it affords no security for minimum state standards as a condition of federal co-operation. In so far as the producer interest in stabilization and the broader public interest in conservation coincide—as they do in large measure—retention by the states of their dominant position in the regulatory process causes no concern in federal circles. But the extent of coincidence is limited. Both federal administrative officials and Congress, consequently, have been loath to view the present regulatory pattern as permanent.

Under the chairmanship of Congressman Cole of Maryland, a special subcommittee of the House Interstate and Foreign Commerce Committee has maintained a watchful eye over the petroleum industry since 1934. None of its five members represents an oil-producing district. While sympathetically inclined toward the industry's efforts to maintain a healthy economic position, therefore, this group is always keenly aware of their potential impact upon consumer interests. After an exhaustive investigation, the Cole Committee recommended

in 1935, as a condition to Congressional ratification of the Interstate Oil Compact, the establishment of an independent federal Petroleum Administrative Board. The Board was to co-operate with the compact states, take over enforcement of the Connally Act, control petroleum imports, and serve as a general research and advisory agency. This proposal was rejected and the compact was ratified without supplementary federal legislation. On each occasion for renewal of the Connally Act, however, both in 1937 and in 1939, the Committee has successfully resisted its continuance without time limit. "Until the principal oil-producing states show a willingness to enact permanent conservation statutes, such as the enforcement of this legislation contemplates," reported the Committee in 1939, "Congress should continue co-operation on behalf of the federal government on a temporary basis only." [5]

In 1938 the National Resources Committee was asked by the President to make a comprehensive study "of our energy sources, their prudent utilization and conservation, and their competitive relation to each other and to the national economic structure." A report, under the title of *Energy Resources and National Policy,* was published early in 1939. While commenting favorably upon the notable advances recently shown in state conservation legislation and upon the benefits of the existing regulatory system as compared with the previous state of chaos, it viewed more extensive federal regulation as an essential safeguard to effective conservation. Salient passages of the report warrant direct quotation:

> In short, the problem of conservation has not been solved by what is, in effect, delegation to the States of certain powers over interstate commerce in oil. No State is now in position to protect itself from another State, and consequently no State can, in equity to its own industry, enforce regulations appreciably more effective than those of other States competing for the same markets. In order to assure the benefits of a continuous stream of reasonably priced liquid fuel for as long as possible for the national defense; for the people as a whole; for all the States, oil producing and non-oil producing; and to protect those States that desire conservation against those considering only the immediate gain, the Federal Government should be in position, in co-operation with the States and the industry, to establish standards for production designed to prevent waste, to encourage conservation, and to protect interstate and foreign commerce from the burden of oil produced in violation of such standards. . . .

[5] H. Rept. 807, 76th Cong., 1st Sess., p. 9.

An appropriate Federal agency would be required to administer the Federal interest in the oil and gas industry and to make necessary rules and regulations concerning the production of and commerce in oil and gas. Such regulation under Federal auspices should be co-ordinated with a rational policy concerning exports and imports of petroleum undertaken with the aim of conserving the Nation's reserves.

It is recognized that the development of minimum standards for the production and transportation of oil and gas designed to further the national interest in conservation of these resources is a complex problem and that such standards should be developed in co-operation with the State regulatory agencies and the representatives of the industry. . . . It is further recommended that . . . a Federal measure be enacted defining in general terms minimum standards for the production and transportation of oil and gas; creating an appropriate Federal administrative agency in order that the experience of the Federal Government, the State regulatory commissions, and the industry may be pooled in the establishment of detailed standards and regulations designed to protect the national interest in the scientific production and conservation of these irreplaceable resources.[6]

Following these recommendations, a bill was drafted by the Interior Department, introduced at the President's request, and made the subject of further hearings by the Cole Committee. The bill provided far more extensive federal authority than earlier proposals. An Office of Petroleum Conservation would be established in the Interior Department, directed to investigate production practices in all oil and gas fields and to make findings with regard to their effectiveness in avoiding physical waste. Upon a finding of wasteful practices, the Commissioner of Petroleum Conservation would, by regulation, "designate and define with particularity those methods and practices which he shall find to be wasteful"; [7] whereupon they would become violations of law subject to federal criminal action and restraint by injunction. The bill specified various engineering standards as a guide to the definition of waste. The concept of "economic waste" played no part in its provisions. The Commissioner was also to be empowered to consider and approve proposed voluntary agreements among operators designed to eliminate avoidable waste.

Hearings on this measure evoked violent opposition both from producing interests and from representatives of the producing states.

[6] National Resources Committee, *Energy Resources and National Policy,* 1939, pp. 33–34.

[7] Section 6(b), H.R. 7372, 76th Cong., 3rd Sess.

Governor Phillips of Oklahoma declared that it represented a deliberate attempt on the part of the federal government "to take over a great industry and to take away states' rights and supersede state authority."[8] Criticisms related in part to the assumption of new federal power and in part to the discretionary authority which would be lodged in the administrative agency.

At the conclusion of the hearings in the spring of 1940, Congressman Cole asked the President whether the vigor and unanimity of state and industrial opposition demonstrated at the hearings suggest "any different approach for the problem before us from a legislative standpoint than that imposed in H.R. 7372." The President replied with a compromise suggestion. He proposed that the Connally Act be modified to require minimum federal standards to ensure conservation, but that they be federally enforced only in states failing to enact or enforce satisfactory legislation. Where producers in particular fields established sound practices by voluntary agreement, they would be permitted to ship in interstate commerce even in the absence of adequate state-wide regulation. The commerce clause would thereby be employed as a weapon to compel minimum conservational standards from the states. The recommendation was renewed in November, 1940, in view of the importance of petroleum to national defense, and the Cole Committee promised a final report early in the 77th Congress.

The conflict between state and federal authority in this field reflects fundamental underlying cleavages of interest. The welfare of the oil-producing states is inextricably intertwined with the economic condition of the industry. They share a comprehensible fear of control by a political unit which is potentially more responsive to consumer than to producer interests. On the other hand, the urgency of conservation needs, the national importance of the industry, and the possibility of abuse of regulatory powers through the limited interests of the producing states are obvious. Thus far, the consumer interest has remained quiescent, largely because discoveries have kept pace with production and improved refining techniques have maintained a downward price trend for petroleum products at a rate sufficient even to absorb increasingly heavy taxes. In the short run, the consumer has more to gain from improved distributive efficiency than from reorganization in the machinery of production control.

[8] House Interstate and Foreign Commerce Committee Subcommittee, *Hearings on Petroleum Investigation,* 76th Cong., 3rd Sess., 1940, Part 3, p. 973.

When a period of sustained fall in petroleum reserves sets in, however, the objectives of price stabilization and conservation may come into increasing conflict. In the words of Northcutt Ely, a leading student of the problem: "It is an open question whether the conservation laws will be applied to limit production for conservation's sake alone, when stabilization of overproduction is no longer a factor." [9] Maintenance of a price structure covering the costs of inefficient stripper wells will then be reflected in the market place by higher prices for gasoline and in the political arena by consumer pressure for federal intervention. The threat of federal action has doubtless already been a potent factor in promoting increased state consideration for physical conservation. Unless far more thoroughgoing measures in this direction are undertaken by the states, individually or through interstate compact, a further shift toward the national government in the balance of regulatory control is to be expected.

2. Bituminous Coal

Public policy toward the bituminous coal industry [10] is derived primarily from pressure by operators and labor and is directed toward economic stabilization. Although basically similar to oil regulation in this respect, it presents a number of sharp contrasts. In the first place, instead of a rapidly growing and highly prosperous industry suddenly faced with sharp economic reversal, bituminous coal has been chronically depressed ever since the first World War. As the nation's leading "sick industry" throughout the decade of the twenties, its troubles were accentuated beyond endurance by the Great Depression. Secondly, labor plays a very large role in this industry, and organized labor has been a dominant element in bringing about the

[9] N. Ely, "The Conservation of Oil," 51 *Harvard Law Review* 1209, 1240–41 (May, 1938).

[10] The anthracite coal industry, which produces about 50,000,000 tons per year compared with about 500,000,000 tons of bituminous, presents entirely different problems. Although competition of other fuels, notably heating oil, has made serious inroads into its demand, the industry's reaction to the change is conditioned by highly concentrated control in the hands of a small group of producers. Together with the anthracite-carrying railroads, they have frequently been an object of prosecution under the antitrust laws. In recent years a uniquely perplexing difficulty has arisen in the form of organized "bootlegging" of anthracite from closed mines by unemployed miners. Since production is almost wholly within the single state of Pennsylvania, public policy in this field remains a matter exclusively of state concern. The present discussion is restricted to the bituminous industry.

modern forms of regulation. The widespread dispersion of the deposits, thirdly, makes state regulation clearly impossible, so that proposals for effective control have always been couched in terms of federal action. The technology of production, although also stimulating excess capacity, is, of course, entirely different from that of the petroleum industry. Conservation, finally, is a much less important element in the rationale of regulation, although it is not to be wholly neglected.

THE BACKGROUND OF FEDERAL REGULATION

The bituminous coal industry is the major source of the nation's energy supply, providing almost half of the total.[11] It is by far the most important fuel substance in railroad transportation, electrical generation, and most manufacturing industries. In addition to its uses as a fuel, coal and its by-products are important raw materials for a wide range of chemical processes. The industry employs over half a million men. It is the backbone of the economy of West Virginia and occupies a prominent position in Pennsylvania, Illinois, Ohio, Kentucky, and significant areas of other states. The importance to the public of a continuing adequate supply of coal at reasonable prices needs no demonstration.

The major troubles of the industry spring from overcapacity. Production expanded rapidly throughout the nineteenth century, but after 1890 the rate of expansion declined sharply and was transformed into actual contraction shortly after the first World War. The fall in demand was a result in part of decelerating population growth, but must be attributed chiefly to increased efficiency in consumption

[11] More detailed materials on the economic background of bituminous coal regulation may be found in National Resources Committee, *Energy Resources and National Policy*, 1939; the brief for government officers in *Carter* v. *Carter Coal Co.*, Nos. 636 and 651, United States Supreme Court, October term, 1935; briefs, record, and decision in *Appalachian Coals, Inc.* v. *United States*, 288 U.S. 344 (1933); F. E. Berquist and associates, *Economic Survey of the Bituminous Coal Industry under Free Competition and Code Regulation*, NRA Work Materials, No. 69, 1936; T. A. Veenstra and W. G. Fritz, "Major Economic Tendencies in the Bituminous Coal Industry," 51 *Quarterly Journal of Economics*, 106–130 (November, 1936); and J. P. Miller, "The Pricing of Bituminous Coal: Some International Comparisons," in C. J. Friedrich and E. S. Mason, *Public Policy*, 1940, pp. 145–175. The official statistics on the industry are summarized annually in the *Minerals Yearbook*, published by the Department of the Interior, Bureau of Mines. The published hearings on the Bituminous Coal Conservation Act of 1935 and earlier proposed legislation also contain much useful information.

and to the substitution of other energy sources. In shipping, domestic heating, and elsewhere, coal has largely been displaced by fuel oil. Natural gas and hydroelectric power have also contributed to the decline. The proportion of total energy supplied by bituminous coal has fallen from almost 90 per cent at the beginning of the twentieth century to less than 50 per cent today.

The disproportion between capacity and demand was magnified by the sudden increase in consumption during the first World War. Many new mines were opened and abandoned workings were brought back into operation. The postwar contraction, to be sure, caused a considerable reduction in capacity. Between 1923 and 1932 the number of mines and miners both fell by about 42 per cent. But the technology of production and the economic organization of the industry kept the reduction in capacity far behind the reduction in demand. Entry into the coal mining industry is more readily undertaken than exit from the industry. Once opened, mines often cannot be temporarily shut down without permanent damage and abandonment. Local taxes upon coal in the ground stimulate owners to resume operations whenever the slightest margin over direct costs is in prospect. Since the industry is the exclusive source of livelihood for the inhabitants of most coal mining counties, labor transfer is difficult. Maintenance of production through wage reductions, even below normal subsistence standards, is feasible for long periods. At the same time, the unusually wide dispersion of mining ownership and control prevents output restriction by voluntary co-operative action.

The peculiar labor conditions of the post-World War I decade also contributed to the maintenance of overcapacity. Wages approximate three fifths of the total cost of bituminous coal at the mine, a larger proportion than in almost any other industry. Pressure on wage rates and disputes over union organization have consequently always characterized the industry. The labor history of bituminous coal is replete with episodes of bitter and violent conflict. Like many other unions, the United Mine Workers of America had gained heavily in strength during the temporary prosperity of the war period. Their organization was most effective in the northern Appalachian fields, Ohio, and Illinois. In the immediate postwar years, organization and wages were maintained in the North but the union was broken in the South. In consequence, there was a marked southward shift of production and a consequent over-all increase in capacity. Many

Northern mines which closed temporarily were later reopened with nonunion labor and lowered wage rates.

From the industry's failure to contract capacity in step with reduced demand there resulted steady pressure on prices and, in turn, on wages. The average mine realization was more than halved between 1923 and 1932, falling from $2.68 per ton to $1.31. At the same time, total annual wage payments fell from $851,000,000 to $235,000,000. While the most precipitous decline occurred after the onset of the general depression in 1929, it had been serious throughout the late twenties. Despite the reduction in labor costs, the industry as a whole was losing heavily. Bankruptcy and reorganization were common. The already seriously weakened position of mine labor was further menaced by a rapid increase in mechanization.

Competitive methods of the industry and an unusual market structure accentuated its troubles. Coal cannot be stored economically above ground for any length of time because of deterioration, fire hazard, and the large amount of space required. Various sizes and qualities produced jointly are marketable at differing prices; the less desirable types must often be sold immediately at any price obtainable. By strategic use of their heavy buying power, large industrial, utility, and railroad consumers could take advantage of the relatively unorganized sellers to keep prices at a low point.

Under these conditions, impoverishment of worker and entrepreneur alike was reflected in impoverished communities and growing demands for remedial action. In the formulation of resultant public policy conservation played a negligible part. It is nonetheless a factor of considerable objective significance. Although the total bituminous reserves of the nation are adequate at present consumption rates for several centuries, they are concentrated, for the most part, in relatively inaccessible areas of the Rocky Mountains. The better seams in the easterly regions, close to large consuming centers, are being exhausted fairly rapidly. Their useful life must be reckoned only in decades. The extreme competitive pressures of the industry force operators to extract only the most easily workable material, regardless of permanent abandonment of only slightly inferior coals. Experience indicates that, apart from government compulsion, economic stability induces improved practices which avoid a considerable degree of physical waste. Moreover, stabilization may create a framework within which minimum conservational requirements can be imposed. Such meas-

ures promise to produce, in the long run, benefits far greater than their costs.

THE MOVEMENT FOR GOVERNMENT CONTROL

Active public intervention in the bituminous coal industry was first undertaken in the first World War and immediate postwar years.[12] The extraordinary increase in requirements, coupled with severe bottlenecks in railroad transportation, led to sharp price increases and demands for control in the interest of consumers. Under the Lever Act of 1917, the United States Fuel Administration fixed maximum coal prices, allocated shipments, and aided in the adjustment of labor disputes. Price control measures were terminated early in 1919. During the next three years, however, repeated labor disturbances prolonged the threat of coal shortage and on two occasions brought about partial restoration of wartime controls.

The strike of April, 1922, the worst in the industry's history, affected almost three quarters of the total production. The office of Federal Fuel Distributor was created, with authority to distribute the limited supply of fuels for the duration of the emergency. Congress also set up an investigatory commission to consider the ownership, organization, costs, labor conditions, and other factors in the coal industry and to make recommendations for public policy. This commission proposed an increase in government control, implemented through supervision of distributive channels by the Interstate Commerce Commission. Termination of the strike, however, had brought the industry out of the era of temporary shortage and high prices into a long downward swing into chronic depression and cutthroat competition. With this shift, beginning in the year 1923, problems of the coal industry and the movement for public control were turned away from consumer protection toward the welfare of operators and miners. The Coal Commission's recommendations, therefore, went unheeded.

An effort to mitigate the effects of overcapacity, at least in their influence on labor standards, was made for a time with some success by the well-organized United Mine Workers Union. The 1922 strike,

[12] The unusually hazardous nature of this industry led to state legislation promoting mine safety many decades ago. The Bureau of Mines was established in the Department of the Interior in 1910 to supplement these provisions. The Bureau now also engages in general promotional and research activities in connection with coal and other mining industries. The discussion in the text is confined to economic regulation.

however, weakened the union's influence in the South. Although wage rates were maintained in the Northern fields between 1924 and 1927 under the "Jacksonville Agreement," the southward trend was accelerated by the wage differential and in the latter year union organization was largely broken down in the North. The union's position was further weakened by a series of prosecutions under the antitrust laws and the enforcement against it of "yellow-dog" contracts. At the pit of the depression, it reached its weakest point since the end of the nineteenth century.

Efforts at voluntary control by operators were equally unsuccessful. The antitrust laws were an obstacle to binding arrangements, while looser agreements were unable to withstand the competitive pressure. In 1932 a joint sales organization, Appalachian Coals, Inc., was set up among producers in the Appalachian territory. Its operation was suspended pending a determination of its legality under the antitrust laws. By the time it had received judicial approval, more effective organization was in operation under the terms of the National Industrial Recovery Act.

The failure of voluntary controls, from either the workers' or the employers' side, to remedy the evils of the industry led to increasing pressure for government intervention. During the late twenties a number of measures to this effect were introduced into Congress. A proposal put forward in 1928 would have established a Federal Coal Commission to supervise joint marketing agencies and intercompany amalgamations, at the same time exempting the industry from the antitrust laws. Producers were sharply divided in their attitude toward government control. The majority still hoped for some form of effective industrial "self-government." The organized workers, who were more anxious for government support, were then too weak to evoke serious legislative attention. By 1932, however, conditions had become desperate. As the depression deepened, increasing numbers of producers came to favor protective legislation. The leading contenders for approval were the Davis-Kelly Bill, providing for antitrust law exemption and guarantees of collective bargaining through federal licensing of interstate producers, and the Lewis Bill, which envisaged production control and minimum price fixing. With the passage of general legislation in the form of the National Industrial Recovery Act of 1933, the demand for special bituminous coal regulation was temporarily dropped.

Although the Bituminous Coal Code was approved only three

months after passage of the NIRA, its negotiation was as complex and difficult as any in NRA history. The savage interregional competition characterizing the industry was transferred to the code drafting offices. Drafts were submitted by producers from each important district. Nonunion operators were hostile to guarantees of collective bargaining. Producers in the South, who had been favored by recent shifts in the industry, were loath to permit any reduction in wage differentials or any other action which might freeze the existing regional distribution of production. Operators as a whole were suspicious of the intrusion of government representatives into code administration and in many cases resisted even the opening of cost records to government inspection. A vital part in the entire proceeding was played by the United Mine Workers, who had begun an extremely effective organization drive immediately after passage of the Act.

The code followed the general pattern of the NRA in exchanging labor concessions for opportunities to mitigate the pressures of competition. In keeping with the extreme distress of the industry, the code went to the unusual lengths of adopting outright minimum price fixing as the basic instrument of producer protection. Agreement on a uniform code for all districts, however, was achieved only at the cost of studied vagueness in many of the operative provisions and of geographical decentralization in code administration. Administration, including control of prices, was placed in five divisional code authorities, with a voting membership composed entirely of producer representatives. They also included a single nonvoting "presidential" member appointed by the Administrator. Labor representation was added only at a later stage. During the code's brief existence, a series of eight amendments substantially clarified its terms. The evolution followed two paths. Increased labor protection developed *pari passu* with the growing strength of the union. At the same time, standards and techniques for minimum price fixing were restated with considerably increased precision, although they still left an enormous range of discretion in the hands of the divisional code authorities.

The position of both workers and operators was clearly improved during the period of code control. Union organization was extended to over 90 per cent of the industry. Child labor was eliminated. The 35-hour week became standard. Annual earnings rose by 35 to 50 per cent and the number of mineworkers showed a moderate increase. Price increases were sufficient not only to absorb increased

labor costs, but also to eliminate most of the operating deficit of previous years and, in many cases, even to provide a moderate profit. From the low point of $1.31 per ton in 1932, average mine realizations rose to $1.75 in 1934 and $1.77 in 1935. In the major producing areas they were as high as $1.86, providing a 3-cent margin over total costs.

Individual dissatisfaction with the regulatory system, however, was rife. Small producers charged domination of the code authorities by larger competitors. Particular regions alleged unjust discrimination in the setting of wage or price differentials. Enforcement of code provisions proved impossible and, as evidence of noncompliance mounted, the price structure broke down in ever-widening areas. By the time of the *Schechter* decision in May, 1935, the coal code had virtually disintegrated. Restoration of the pre-existing situation was widely feared. Steps were taken in the winter of 1935, therefore, to replace the code structure with a "little NRA," based upon special bituminous coal legislation with more adequate standards and administrative procedure. The movement culminated in passage of the Bituminous Coal Conservation Act in August, 1935.

SPECIAL BITUMINOUS COAL LEGISLATION

As originally introduced, the 1935 Bill contained provisions not only for labor protection and price control, but also for allocation of production quotas and the retirement of marginal coal lands by government purchase financed out of a tax on the industry. It announced itself as seeking to regulate bituminous coal "as a public utility." Guided through Congress by Senator Guffey of Pennsylvania, its leading sponsor was the United Mine Workers Union. Among the operators the divisions which had created such serious impediments to NRA code formulation and administration again asserted themselves. While it was widely conceded that production control was a relatively simple and direct solution to the problem of overcapacity, each proposed formula for the allocation of quotas met with warm opposition from important producing groups. Railroads and various other large consumers opposed the imposition of any regulatory plan. Spokesmen for smaller consumers were also troubled by the proposals; their representations resulted in the establishment of the consumers' counsel device discussed in Chapter 7. Since acceptance of any control legislation under the then existing conditions necessitated the support of a substantial portion of the operators as well as the

union, positive action was obtained only by the elimination of production controls and of the national coal reserve. Southern Appalachian operators opposed the Bill to the very end. Its final passage was achieved by the close votes of 194 to 168 in the House and 45 to 37 in the Senate.

As enacted, the Bituminous Coal Conservation Act built upon the code experience by limiting itself to minimum price fixing and regulation of labor conditions. A National Bituminous Coal Commission of five members was established as the agency of administration. Members were forbidden to have any financial interest in the coal or related industries. Producers were induced to submit themselves to regulation by a 15 per cent tax on the sale of coal at the mine, 90 per cent of which was remitted upon acceptance of the new "Bituminous Coal Code." Minimum prices were to be established by twenty-three district boards of producers, each board containing a single labor representative. Guiding criteria were laid down for regional price determinations and for co-ordinating various district prices in common consuming areas. The entire process was subject to Commission scrutiny and modification. The Commission was also given power to impose maximum prices under emergency conditions. The labor sections of the Act guaranteed the rights of free organization and collective bargaining, provided for union checkweighmen, and forbade employers to require workmen to live in company houses or trade at company stores. In addition, maximum hours, agreed upon by the producers of over two thirds of the nation's tonnage together with representatives of more than one half the workers, were to become binding upon all code members. The Commission was to receive all information necessary to enforce compliance with the Act and might, as its ultimate sanction, revoke code membership, thereby reimposing the prohibitory tax upon the offending producer.

No sooner had the Act of 1935 become law than steps were taken by opposing producers to test its constitutionality. Ten months later it was held invalid by the Supreme Court.[13] The labor provisions were declared beyond the scope of federal authority under the commerce clause. They sought to regulate production rather than commerce, it was argued, and their effect upon the latter was held to be indirect. And the compulsory extension to an unwilling minority of labor conditions agreed upon by a majority of the industry was

[13] *Carter* v. *Carter Coal Co.*, 298 U.S. 238.

held to be an unconstitutional delegation of legislative power to private persons. The labor and price-fixing provisions were found by the Court to be so closely related to one another that with invalidation of the one the other had necessarily to fall as well. "The price-fixing provisions of the code," concluded Justice Sutherland, "are thus disposed of without coming to the question of their constitutionality; but neither this disposition of the matter, nor anything we have said, is to be taken as indicating that the Court is of opinion that these provisions, if separately enacted, could be sustained." Chief Justice Hughes, concurring, and a dissenting minority of three other justices, expressed their conviction that the price-fixing provisions were constitutional.

Proponents of regulation wasted no time in taking the cue given by the Court. Within three weeks of the decision, a new measure was introduced into Congress to re-enact the price-fixing provisions with only minor alterations, but omitting the labor sections. Protection for collective bargaining was now provided under the terms of the National Labor Relations Act of 1935. With regard to wages and hours, the mineworkers' position was well stated by their counsel at hearings on the new bill. "We thought we could deal with the industry and rely on our own power," he said, "if the industry was not chronically insolvent." [14] Deletion of the labor provisions and a slight broadening of the standards guiding the price-fixing process served to eliminate much of the producer opposition. Although a few producing groups, notably those of Alabama, together with many large consumers, retained their hostility to the law, general sentiment was more favorable than in 1935. Actual passage was delayed until the 1937 session of Congress, but it was then obtained by the large margin of 58 to 15 in the Senate and without a record vote in the House.

PRICE FIXING UNDER THE BITUMINOUS COAL ACT OF 1937

The new statute opened with a declaration of policy in the following terms:

> That regulation of the sale and distribution in interstate commerce of bituminous coal is imperative for the protection of such commerce; that there exist practices and methods of distribution and marketing of such

[14] Senate Interstate Commerce Committee, *Hearings on S. 4668, to Regulate Interstate Commerce in Bituminous Coal,* 74th Cong., 2nd Sess., 1936, p. 36.

coal that waste the coal resources of the Nation and disorganize, burden, and obstruct interstate commerce in bituminous coal, with the result that regulation of the prices thereof and of unfair methods of competition therein is necessary to promote interstate commerce in bituminous coal and to remove burdens and obstructions therefrom.

The National Bituminous Coal Commission was now expanded from five to seven members. Commissioners were forbidden to have any financial interest in the coal or competing fuel industries, but two members were to have had previous experience as operators and two as mineworkers. Qualifications for the remaining three were not stated. The motif of industrial self-government was thus carried over from the NIRA by giving to the industry a clear majority on the regulatory agency. It was balanced to some extent by the independent consumers' counsel, whose authority and functions have been described in Chapter 7. The Commission was placed within the Interior Department for housekeeping purposes, but was otherwise independent.

A vestigial trace of the labor provisions in the 1935 Act was retained in a declaration of public policy, favoring collective bargaining free from company domination and giving the Commission authority to supervise compliance with this condition. Real reliance for labor protection was now placed in the strength of the union and in laws of general applicability. The Commission was also given broad authority to conduct research on coal production, distribution, utilization, and conservation, and on the promotion of safe operations. The heart of the statute, however, lies in the price-fixing provisions.

The law applies to all bituminous coal produced or sold in or directly affecting interstate commerce. Producers become subject to its provisions by accepting membership in a Bituminous Coal Code. Failure to accept the Code entails a 19½ per cent tax upon the market value of all coal within the jurisdiction of the Act. In addition, an excise tax of 1 cent per ton is designed to return to the government the costs of administration.

Coal-producing regions are divided into ten minimum price areas, subdivided in turn into twenty-three districts. In each district a board is established, composed of two to sixteen producers and one labor representative. Balance between large and small concerns is sought by the election of half of each board by a numerical majority of the producers and of half in proportion to their tonnage output. The Commission also established in each district or convenient group of

districts a statistical bureau for the assemblage and computation of cost data.

The price-fixing process is undertaken in six distinct steps. (1) Code members report to the appropriate statistical bureau all spot orders, contracts, invoices, and basic data essential to determination of their costs. This information is assembled by the bureaus and made the basis for determinations by each district board of the weighted average total costs per ton for the coal produced in its district. (2) Cost determinations for each district are reviewed by the Commission and combined into weighted average total costs for each minimum price area. (3) Each district board proposes minimum prices at the mines "for kinds, qualities, and sizes of coal produced in said district"—together with "classification of coal and price variations as to mines, consuming market areas, values as to uses and seasonal demand." Proposed prices are to return for the district as a whole a yield per ton equal to the weighted average per ton costs for the minimum price area in which the district is included. Costs include all ordinary operating expenses, royalties, depreciation and depletion, selling, and administration, but exclude interest on bonded debt, income taxes, and allowance for profit. (4) The proposed prices are submitted to the Commission for review and modification. (5) Where coal from several districts enters common consuming market areas, the district boards (or, in case of their failure to act, the Commission) must co-ordinate the prices. (6) The co-ordinated prices, together with appropriate rules and regulations, are submitted to the Commission for further review and final promulgation.

Detailed criteria are established by the Act both for the originally proposed minimum prices and for their co-ordination. The proposed minimum prices "shall reflect, as nearly as possible, the relative market value of the various kinds, qualities, and sizes of coal, shall be just and equitable as between producers within the district and shall have due regard to the interests of the consuming public." The criteria for co-ordination are stated in the following terms:

> Such co-ordination, *among other factors, but without limitation,* shall take into account the various kinds, qualities, and sizes of coal, and transportation charges upon coal. All minimum prices proposed for any kind, quality, or size of coal for shipment into any common consuming market area shall be just and equitable, and not unduly prejudicial or preferential, as between and among districts, shall reflect, as nearly as possible, the relative market values, at points of delivery in each common consuming

market area, of the various kinds, qualities, and sizes of coal produced in the various districts, taking into account values as to uses, seasonal demand, transportation methods and charges and their *effect upon a reasonable opportunity to compete on a fair basis,* and the competitive relationships between coal and other forms of fuel and energy; *and shall preserve as nearly as may be existing fair competitive opportunities.* The minimum prices proposed as a result of such co-ordination shall not, as to any district, reduce or increase the return per net ton upon all the coal produced therein below or above the minimum return as provided in subsection (a) of this section by an amount greater than necessary to accomplish such co-ordination, to the end that the return per net ton upon the entire tonnage of the minimum price area shall approximate the weighted average of the total cost per net ton of the tonnage of such minimum price area.[15]

The Commission is also authorized to establish maximum prices to protect consumers in the event of an emergency. This provision, however, is of doubtful efficacy, since it requires that maxima be set at a uniform increase above existing minima, that they yield a reasonable return above weighted average total costs in the aggregate, and "that no maximum prices shall be established for any mine which shall not yield a fair return on the fair value of the property." Since the latter proviso fixes the entire level of maxima by reference to profitability of the least efficient mine, the section would be extremely difficult to apply and would afford but little protection in practice.

Sales below fixed minimum prices, together with thirteen specified unfair methods of competition designed to avoid indirect price shading, constitute code violations. Contracts containing such violations are unenforceable. Compliance with the Code is provided in three ways. (1) The Commission may issue a cease and desist order, which is enforceable upon application to a circuit court of appeals. (2) The Commission may revoke Code membership, thereby subjecting the producer to the 19½ per cent tax. (3) Competitors are granted triple damages in suits against Code violators. Elaborate safeguards against the abuse of administrative discretion are contained in both the price-fixing and the Code-enforcing provisions, in the form of requirements for notice, hearings, findings of fact, and judicial review.

The Act also makes provision for common marketing agencies on the pattern of Appalachian Coals, Inc., subject to Commission ap-

[15] Italics not in original.

proval and supervision. Approval may be granted only upon a finding that the agreement will not unreasonably restrict coal supplies, prevent the public from receiving coal at "fair and reasonable prices," or "operate against the public interest." By mid-1939, provisional approval had been given to eleven agencies, with a membership representing about one fifth the total annual production.

Challenges to the constitutionality of the 1937 Act were instituted immediately, but were foredoomed to failure by the altered trend of interpretation now adopted by the Supreme Court. The issue was definitively resolved in 1940 by an eight to one decision. The scope of the Act was held to be well within the bounds of the commerce clause. To contentions of its failure to meet the requirements of due process, Justice Douglas replied: "If we undertook to narrow the scope of federal intervention in this field . . . we would be blind to at least thirty years of history. . . . If the strategic character of this industry in our economy and the chaotic conditions which have prevailed in it do not justify legislation, it is difficult to imagine what would." [16] The method of regulation, to the mind of the Court, was a matter within the domain of legislative policy, not constitutional law.

The administrative task facing the National Bituminous Coal Commission is probably the most complex undertaking ever entrusted to a regulatory agency. The establishment of some 400,000 separate prices under any conditions is a problem to stagger the imagination. When the function must be performed in accordance with the intricate criteria and the procedural limitations of the Bituminous Coal Act, any group of administrators might well boggle at its assignment. Nonetheless, the Commission set about its task with remarkable celerity. A first attempt at establishment of general price minima was thwarted at the end of 1937 because of excessive haste and the omission of several procedural stages. The second effort, begun early in 1938, finally reached fruition in October, 1940.

Organization of operations under the Act coincided with the sharp, general industrial recession of 1937. The consequent drop in demand for coal intensified competitive stresses and placed the Commission under heavy pressure to establish price protection in the shortest possible time. The Code was promulgated in June and received the immediate acceptance of 95 per cent of the industry. Remaining producers, for the most part, claimed exemption on the

[16] *Sunshine Anthracite Coal Co.* v. *Adkins,* 310 U.S. 381 (1940).

ground of purely intrastate operations. Costs were tentatively determined by the Commission itself and the district boards were ordered to propose minimum prices on this basis. Since the boards proved unable to agree on interdistrict co-ordination, this function was likewise assumed by the Commission. Final price schedules were promulgated early in December, without prior public hearings. The procedure was clearly in conflict with statutory requirements. The Commission was faced with a flood of temporary injunctions. Although price levels improved for a month or two, competition from producers challenging enforcement of the Commission's schedules on legal grounds soon destroyed the structure. The prices were revoked in February, 1938.

In the second phase the Commission leaned over backward to observe statutory procedural requirements to the full. Every effort was made to forestall complaint through informal co-operation. The first chairman, a producer representative who had been severely criticized for the initial fiasco, resigned in April; he was replaced by a more conciliatory member from the labor side. After a series of conferences with the district boards and the consumers' counsel, a new and highly formalized procedural schedule was arranged. It provided for public hearings at each of the three major stages: cost determination, proposed prices, and price co-ordination.

The first stage occupied two months in the summer of 1938. It was followed by three months of minimum price hearings in the autumn. Considerable delay was occasioned by litigation over the right of the Commission to open individual cost data to public inspection and cross-examination.[17] Minimum price hearings were completed only at the end of March. Efforts at co-ordination by the district boards again proved in vain, and the Commission itself undertook this final stage in mid-May.

At this point the form of the agency was radically altered by abolition of the Commission and transfer of its functions to a Bituminous Coal Division under the direct supervision of the Secretary of the Interior. In explaining the transfer, carried out under authority of the Reorganization Act of 1939, President Roosevelt declared: "The Congress placed this Commission in the Department of the Interior, but experience has shown that direct administration will be cheaper, better, and more effective than through the cumbersome medium of

[17] The issue was resolved in the Commission's favor in January, 1939. *Utah Fuel Co. v. National Bituminous Coal Commission,* 306 U.S. 56 (1939).

an unnecessary Commission." The work of the Commission had, in fact, suffered badly from widespread charges of personal incompetence, wastefulness, and favoritism toward particular producers and large consumers. In an industry as battle scarred as bituminous coal, such criticism of regulators drawn from within was almost inevitable. The Division's relations with the industry have, in practice, been far smoother than those of its predecessor. It is noteworthy that this formal transformation from an effort at industrial self-government to outside governmental supervision occasioned little or no opposition.

While substantially modifying internal organization and personnel, the Division maintained the price-fixing procedure intact. Hearings on co-ordinated prices were steadily continued throughout the summer and autumn of 1939; they were finally closed early in 1940. Opportunity was afforded for the filing of briefs and oral argument first before trial examiners and later before the Director of the Division. Further briefs were submitted for consideration by the Secretary of the Interior. The final schedules were promulgated during the summer of 1940 and came into effect on October 1. Persons dissatisfied with the schedules may obtain further formal hearings before the Division, with appeal to the courts for ultimate determination.

Cumbersome and time consuming as the process has been, the administrators have demonstrated the physical feasibility of carrying out the terms of the 1937 Act. Remarkable ingenuity has been displayed in dealing with the mass of data going into the price-fixing process. Experience with its practical economic effects is as yet far too brief for appraisal. The effectiveness of the enforcement procedures has yet to be tested. Certain weaknesses inherent in the regulatory structure, however, have been apparent from the start.

The price-fixing criteria established by the statute show clear signs of the effort to obtain compromise among a welter of conflicting interests. The very complexity of their terms, which attempt to combine standards both of cost and of market value, necessarily leaves to the Division an enormous area of administrative discretion. The intent of the Act is sufficiently evident; it seeks improvement in the general *level* of prices while leaving pre-existing competitive *relationships* untouched. It remains to be seen whether it can withstand the inevitable discontent of thousands of individual producers desiring betterment of their relative positions.

The policy behind the Act is, in essence, directed toward short-run considerations. It endeavors to remedy an immediate situation. This objective it bids fair to accomplish. Its longer run utility, however, is subject to serious reservations. Through its tendency to freeze existing competitive relations, it may hamper concentration of production in the more efficient mines. Maintenance of prices upon a cost foundation encourages the padding of costs. Although the Division has statutory authority to prescribe uniform accounting methods, it has not yet availed itself of this power. The very success of the Act, moreover, if it proves successful, will raise new problems. Average and high-cost producers may demand inclusion of a profit allowance in the cost base. An upward spiral of costs and prices may accelerate the transfer of consumers to competing fuels, thus worsening the industry's long-run prospects.

Above all, the maintenance of price control as a permanent policy will in due course almost inevitably lead to the imposition of production controls. This prospect was envisaged in the Act by a provision directing the Commission to "investigate the necessity for the control of production of coal and methods of special control, including allotment of output to districts and producers within such districts and . . . hold hearings thereon." Absorption of the administrators' energies by the process of initial price fixing has thus far prevented the effectuation of this mandate. With the improvement in demand consequent upon the current armament expansion, a movement may be expected toward the opening of abandoned and new mines. Against this pressure it will be difficult to maintain and enforce a regulated price structure. Experience in Great Britain and Germany indicates that production controls are feasible and administratively far simpler than the policy adopted in this country. Through suitable provisions for transfer of quotas, they may be readily adapted to the promotion of improved over-all efficiency. If a permanent decline in the relative position of the coal industry is to be accepted as a matter of public policy, moreover, pressures will undoubtedly arise for public assistance in the transfer and retraining of redundant labor.

The Bituminous Coal Act expires by statutory limitation in April, 1941. Since three and a half years of its brief life have been occupied in getting its administration under way, it will probably be retained in an unaltered state for a further period. In the words of the National Resources Committee, "this Act is a step in the evolution of a

permanent national policy toward the greatest of our energy resources and no effort should be spared to make the test conclusive."[18] Thus far it has brought temporary relief to a sector of the economy so hard pressed that broader implications of its methods have been neglected. As experience under its terms accumulates, however, public policy will be faced with the more delicate problem of finding an equilibrium between the special interests of this particular industry and the broader interests of consumers, competitive energy resource industries, and the economy as a whole.

3. The Significance of Special Industry Regulation

Contemporary experiments in the oil and bituminous coal industries are not only highly significant in themselves; they also exemplify two trends of major importance in the evolving pattern of governmental relations to the American economy. One is the adoption of far-reaching regulatory measures at the behest of entrepreneurs themselves and directed toward their protection from the consequences of unbridled competition. The other is the elaboration of substantive policy and administrative techniques to fit the particular needs of unique industry situations.

As "producer legislation," these measures form a striking contrast with both public utility and antitrust regulation. They unquestionably raise grave issues of public policy in their potential impact upon consumer welfare. Their extension to a substantial segment of the economy would threaten the dynamics of economic change with a form of structural arteriosclerosis. Yet they are a normal outgrowth of the ills wrought by unmodified competitive forces in the particular circumstances of these industries. The politics of modern democracy will not permit the desolation of entire communities dependent upon a basic occupation, like the mining of bituminous coal, in the fashion of the British hand-loom weavers of the early nineteenth century. Democratic institutions cannot but respond to dislocations arising out of wild fluctuations in the economic position of so vital an industry as petroleum. Pressure for some form of governmental intervention is irresistible. The task for public policy is the satisfaction of such demands in the manner most closely in accord with the broad requirements of general welfare. Fundamental geographical or technological shifts may be guided, and their impact upon par-

[18] *Energy Resources and National Policy*, p. 33.

ticular disadvantaged interests softened, without sacrificing the essential needs of economic advancement. To a considerable degree, the objective of conservation may be superimposed upon, and sought simultaneously with, that of stabilization. Recent trends in oil regulation display such a tendency; in the case of bituminous coal it has yet to be forthcoming.

Adaptation of policy and administration to the peculiar technological and organizational requirements of particular industries is equally noteworthy. The old dichotomy between "natural monopolies," requiring regulation on the public utility model, and the remainder of industry, which was thought to require regulation only to ensure the maintenance of competition, was far too simple to fit the needs of the modern economy. No industry is wholly free from the influence of government and the degree and form of the influence are conditioned by individual industrial patterns. Growing emphasis upon the distinctive differentiating features, as well as the similarities, of the objects of regulation is to be observed in the recent development of public utility and antitrust policies themselves.

The trend of these policies, however, has intensified the need for co-ordination of government activities. The economy is a seamless web; as intervention extends to successive segments of the whole, government is increasingly faced with the consequences in one sphere of its own actions in another. Policies toward oil and coal affect one another and react, in turn, upon power policy. Energy resource policies exercise significant influence upon transportation and foreign economic policies. Integration of specialized regulatory efforts into a unified public economic policy is a major unsolved problem of public administration.

Part IV

PUBLIC ENTERPRISE AND CONSERVATION

Chapter Eighteen. THE GROUNDS AND SCOPE OF PUBLIC ENTERPRISE

The world-wide increase during the last half century in governmental activity guiding and confining the interrelationships of producers, distributors, and consumers of privately produced goods and services has been accompanied by a striking increase in direct public production by government. The individualistic ideology of classical economic liberalism, which dominated nineteenth-century American attitudes toward the appropriate functions of government, was particularly hostile to such activity. In Adam Smith's view, postal service and a modicum of free public education were the only legitimate extensions of government's domain beyond the traditional areas of external defense, internal order, and the enforcement of contracts; and in advocating public education he was expressing a Scottish attitude well in advance of the then accepted doctrines in either England or America.

While of increasing significance, the scope of American public enterprise is relatively limited by comparison with corresponding development abroad. On the European continent, particularly in Germany and the Austro-Hungarian succession states, extreme laissez-faire liberalism never completely overpowered the firmly established and toughly resistant étatist tradition. Preliberal mercantilism, with its emphasis on positive governmental promotion of national economic welfare, and the neoliberal service state (or its alternative—the modern armed camp state) merged into one another without any sharply defined intervening period. The resultant influences favoring public enterprise were strongly bulwarked by ever-present considerations of military strategy. In England and the British Do-

minions (except for Canada, the position of which closely resembles our own), humanitarian neoliberalism and the mild socialism of organized labor parties have carved out for the state a very sizable share of direct economic activity. The first World War and the subsequent readjustments further accelerated its growth in Europe. In the United States, to be sure, the management and exploitation of our enormous public domain produced a number of examples of government enterprise at an early stage in our national development. For the most part, however, these tasks were transferred as quickly as possible to private hands, generally aided by generous subsidies.

The traditional American attitude toward public enterprise is reflected in repeated attempts during the postwar decade to dispose of the government's Tennessee River properties at Muscle Shoals to private operators. During this same period, numerous complaints were made by business associations of an increasing tendency toward government "usurpation of business functions." Toward the close of the Hoover Administration, a special House of Representatives Committee to Investigate Government Competition with Private Enterprise (commonly known as the Shannon Committee) recommended, with one dissent, the abandonment of such activities and the appointment of a standing committee of Congress to guard against "unwise and unprofitable encroachments of government activity upon private enterprise." It announced its "fundamental considerations" in the following terms:

> The Government, as it now exists, was conceived and organized for political and social control and activity. It was not vested with any economic functions beyond those essential to the proper exercise of its own functions in coining money, collecting and disbursing revenue, emitting credit, operating post offices and carrying mails, and in developing and maintaining military establishments for the protection of the lives and property of its citizens. It was primarily designed "to promote the general welfare," and to conserve to its citizens the rights of "life, liberty, and the pursuit of happiness." The entrance of the Government into commercial and industrial undertakings, backed by public credit and resources and its military and civilian personnel, for the purpose of competing with the business establishments and the opportunities of livelihood of its citizens, is, therefore, in general, repugnant to our fundamental democratic institutions and aspirations. Our people, if they so elect, might decide to own and operate their own utilities, or might declare any branch of industry or business to be affected with a public interest, and through proper legal measures might acquire and operate such economic institu-

tions. Even such extreme action, however, under our Constitution would have to be carried out without any confiscation or impairment of private property, or property rights, but no constitutional authority exists whatsoever which would permit the Government deliberately to engage in business in any form which competes with and impairs the private business of its citizens, except for reasons of economy or fiscal and military expediency.[1]

The Shannon Report illustrates in general terms a widely held American view of the proper functions of government. In specific cases, however, there have appeared here in recent decades, and with increasing frequency, motivations for public enterprise similar to those governing its adoption abroad.

The expression "public enterprise" might be taken in a broad sense to include the entire range of governmental activities. The discussion in this chapter will be limited to economic activities for which some direct payment is made. Taken in this narrower sense, the expression is analogous to "private enterprise," and distinguishes the operation of postal, transportation, utility services, and the like, from services financed out of general taxation such as education, police, and national defense. The border line is necessarily somewhat arbitrary. It is difficult to distinguish between instances of public enterprise where subsidies are involved and other governmental activities for which some purely nominal fee may be charged. With the rapid expansion of the service state, a widening area of activity previously occupied, albeit inadequately, by private enterprise has been absorbed into the category of free public services. This is the case with education, with maintenance of the physically incapacitated, with hospitals, and—in recent years of greatest importance—with unemployment relief. The economic effects of such activities lie chiefly in the shifting composition of the national income and its altered pattern of distribution among various social groups. As the proportion of peacetime national income passing through the hands of government increases—the figure now amounts to from 20 to 35 per cent for all modern industrialized nations—public expenditures come to exert a profound influence upon the volume of economic activity as a whole. We shall concern ourselves here, however, with only the narrower aspects of government ownership and operation.

In other sections of this study there are considered a number of

[1] *Report of the Special Committee Appointed to Investigate Government Competition with Private Enterprise*, H. Rept. 1985, 72nd Cong., 2nd Sess. (1933), p. 18.

topics in which public enterprise is necessarily involved. The development of government ownership as a technique of public utility regulation has been treated in Chapter 12. Conservation of national resources, again, involves a substantial degree of incidental public enterprise.[2] In the development of our social security program the government has undertaken insurance both for old age and for unemployment on a huge scale.[3] Work relief, also, may be viewed as a type of public enterprise, but its ostensibly temporary nature and the effort to avoid competition with private business subject it to special considerations. In the totalitarian nations, finally, public enterprise is naturally carried far beyond its scope in the liberal democracies. In Soviet Russia, particularly, it is, of course, the dominant and almost exclusive form of economic activity. The present treatment will deal only with public enterprise within a general framework of private capitalism.

Modern conditions of warfare involve an increase of government expenditures during wartime to half or more of the national income. Public enterprise in such a period is enormously expanded, not merely in munitions and other war supplies, but also in a variety of basic services. Curtailment of imports may require the establishment of entire new industries for the production of substitutes. German extraction of gasoline from coal in the present war is paralleled by the manufacture of artificial nitrates in that country during the last war. Consideration is now being given, for similar reasons, to the establishment of government tin-smelting plants in the United States.

Unusual demands upon transportation and other national public utilities may also lead to wartime operation by government where they are not already in public hands. Thus the railroads were taken over in both the United States and Great Britain during the first World War. In the summer of 1918, when labor disputes threatened a stoppage of telegraph service, the federal government assumed control of this industry and the telephone system as well, operating them through a committee headed by the Postmaster General. Like the railroads, they were returned to private ownership soon after the termination of hostilities.

Wartime public enterprise is a consequence of the special needs of industrial mobilization, which differ in fundamental respects from

[2] See Chapter 20.

[3] See Chapter 21.

peacetime considerations. In consequence, efforts to appraise the merits of peacetime public enterprise on the basis of war experience are, in most cases, both superficial and misleading. Such comparisons are invalidated from the outset by the peculiar circumstances under which wartime public enterprise is undertaken: the special provisions for compensation of the private owners; the subordination of economic considerations to the requirements of immediate service for essential war needs of transportation, communications, and power; the impossibility of effecting economies of co-ordinated and consolidated operation in the limited time available; and the dislocating effect of war upon the general price and wage structure of the economy.

1. The Motivation of Public Enterprise

A treatment of public enterprise groups together government activities characterized by a common form rather than by similarity in objectives. Its objectives, in fact, cover the entire range of public policy. Promotion of particular interests through public enterprise may be illustrated by the aids to agriculture afforded by the Rural Electrification Administration and the fertilizer program of the Tennessee Valley Authority. Many of the government lending agencies established in recent years, like the Reconstruction Finance Corporation, the Farm Credit Administration, and the Home Owners Loan Corporation, have been designed to sustain the credit structure of various sectors of the economy. The use of the "yardstick" in the electric utility field is an effort to provide more effective regulation through government competition than appears possible through commission supervision.

Entrance by government into the domain reserved by early nineteenth-century liberal theory to private enterprise is predicated upon a variety of motives. For the most part, pressures for such activity closely resemble those forces which have developed the public utility concept in our economic history. A survey of the extent of modern public enterprise reveals a pattern focused around basic services and industries, many of them natural monopolies. They include water supply, communications, transportation, power, credit, natural resources, and miscellaneous heavy industries. Little faith has been placed abroad in the typical American solution for public utilities—private ownership and operation coupled with government super-

vision. Duplication of operators and regulators, deflection of the profit motive into evasion of regulation rather than improved service, and excessive elaboration of procedural organization have regularly led at least to the serious consideration of government enterprise as an alternative.

In some instances, government ownership is used merely as a fiscal device; the match, tobacco, and salt monopolies of Europe are outstanding cases. Such action, analytically viewed, is a substitute for excise taxation upon the commodity concerned, adopted for purposes of convenience and offering no significant problems other than those of pure administration. Municipal enterprises are also frequently conducted primarily as earners of revenue, and often serve as a means of reducing ordinary taxes. This motive is at times combined with a policing function; thus the liquor monopolies adopted in Quebec and in some American states since the repeal of prohibition are intended both to obtain revenue and to avoid the evils of the old-fashioned saloon. Public supply of goods and services for government use is also a common practice. Where the needed quantities are sufficiently large to occupy a plant of reasonably efficient scale, government manufacture avoids the complexities of contract-letting machinery or of cost supervision. It also eliminates a ready source of corruption, which has been the occasion of innumerable scandals in almost every nation. For an important governmental unit, such operations may involve business management on a very large scale. The United States Government Printing Office, for example, is the largest establishment of its kind in the world.[4] Clothing factories for uniforms constitute another common operation of this type. Such establishments do not ordinarily enter the open market, the sale of stamped envelopes through the Post Office being a minor exception. In rare cases public enterprises originating in this manner, like a number of the early telegraph systems, have developed into general public utilities deriving the bulk of their revenue from private consumers.

In many fields private enterprise cannot operate effectively because

[4] An official report was recently submitted to the City of New York, recommending the establishment of a municipal printing plant for the city's work other than textbooks. The proposal was designed to eliminate collusive bidding and other alleged monopolistic practices among local private printers and was expected to save the city $250,000 a year. The plant would be administered under a specialized director of printing, supervised in turn by a semi-independent, nonsalaried, three-member board. (New York *Times*, November 10, 1940.)

of the large risks and small returns involved or because of the length of time required for financial return. Forest management and other natural resource industries offer cases in point. It is widely argued that an increasing share of total capital investment in the future will necessarily be made by government in such fields, looking primarily toward the adjustment of the nation's land uses to changing human needs.

On balance, considerations of public policy other than economic factors have played a larger role than strictly economic motives in widening the field of public enterprise. Such considerations include the provision of services to special groups at less than cost on broad social grounds or as a result of strong political influence. The needs of military preparation are another highly important noneconomic motivation. Just as war itself involves a great expansion of public enterprise, so preparation for war may also lead to its preference over private control. The Panama Canal is one outstanding example. Our subsidized shipping policy, which involves a program of construction by the United States Maritime Commission of five hundred ships over a ten-year period, is also based in part upon this motive.[5] Such public enterprises commonly serve ordinary peacetime needs in addition, but the normal pattern of organization is altered to conform to expected military necessity. Thus, a nation's road or rail network may be designed with a view, among other considerations, to rapid troop movements. The capacity of certain industries may be expanded beyond the point justified solely by peacetime demand. Domestic supply of vital war materials, however high the costs, may be encouraged.[6] While subsidy to private enterprise may sometimes

[5] The declaration of policy in the Merchant Marine Act, 1936, reads as follows:

"It is necessary for the national defense and development of its foreign and domestic commerce that the United States shall have a merchant marine (a) sufficient to carry its domestic water-borne commerce and a substantial portion of the water-borne export and import foreign commerce of the United States and to provide shipping service on all routes essential for maintaining the flow of such domestic and foreign water-borne commerce at all times, (b) capable of serving as a naval and military auxiliary in time of war or national emergency, (c) owned and operated under the United States flag by citizens of the United States in so far as may be practicable, and (d) composed of the best-equipped, safest, and most suitable types of vessels, constructed in the United States and manned with a trained and efficient citizen personnel. It is hereby declared to be the policy of the United States to foster the development and encourage the maintenance of such a merchant marine."

[6] The German *Hermann Goering Werke* for the manufacture of petroleum derivatives from coal were established in 1936 with this end in view.

achieve the desired ends, they are in practice frequently sought through government ownership.

Various adventitious factors have also contributed to the establishment of public enterprises. Some important businesses have been taken over by the state largely to avoid the collapse of their credit structures and consequent losses to private investors. It is widely felt that if the federal government ever assumes operation of the American railway system it will be for similar reasons. In postwar Germany and Austria, financial and economic dislocation made it impossible in many instances to return to private hands industries which had been taken over by the governments during the course of the war. Shipping construction by the United States Maritime Commission likewise has been undertaken only with extreme reluctance as an apparently inescapable concomitant of the subsidized shipping policy.

2. The Extent of Public Enterprise

WATER SUPPLY

The water-supply industry holds a high place in the proportion of the field occupied by public enterprise. In 1937, of the ninety-four American cities with a population exceeding 100,000 only eight failed to operate their own water-supply systems. Financial considerations are secondary in this field and management is relatively simple. Purity and adequacy are the primary concerns. Water supply is so vital to the very existence of large metropolitan areas that expense must necessarily be subordinated to the fundamental needs. Great imagination and enterprise have been shown in the planning of extensive public supply systems carrying water from distant points, as is well indicated by the familiar examples of Boston, New York, and Los Angeles. It is noteworthy, however, that as late as 1903 London's water supply was provided by a number of private companies subject to close supervision. A public Metropolitan Water Board was established in that year, in view of the growing inadequacy of existing supplies and the unsatisfactory experience with regulated private monopoly.

COMMUNICATIONS

In the communications field postal service has universally been a public function for almost two centuries. Here, too, management

is relatively simple and economic return is considered secondary to the basic desirability of an inexpensive and widespread system of communication. The United States Post Office has always extended service to the most remote rural areas, despite the inability of many of them to repay the cost on the basis of uniform postal charges. A substantial element of subsidy is also involved in the low-rate carriage of newspapers and periodicals, and in the recently introduced special rate on books. The associated functions of parcel post and postal savings occasioned serious controversy at the time of their establishment, since they involved clear incursions into the domains of express companies and private banks. Considerations of convenience and of the extension of an easy savings outlet to low-income groups were sufficient to overcome the objections.

European telephone and telegraph services are generally operated by the government in conjunction with the post office. Public enterprise in the telegraph field originated largely from noneconomic motives. In the early days of telegraphy, national governments recognized the importance of quick communication, both administrative and military, well before adequate private capital could be found for the establishment of a satisfactory service. They consequently set up national systems, earning as much revenue as possible by civilian use, but with primary emphasis on direct use by the government.

With the invention of the telephone in the eighteen-seventies, the national telegraph administrations of Germany and Switzerland undertook the new service as a natural extension of their existing operations. The Swiss policy was motivated, in part, by a factor common in more recent arguments favoring public electrical service: a more complete rural coverage than would be likely under a regime of private enterprise. In other nations the earliest experiments in telephone operation were made by private entrepreneurs, frequently with public assistance and in all cases with some form of public control. They were later acquired by the governments, sometimes in the course of unification of a number of private systems, sometimes because of dissatisfaction with the results of regulated private monopoly, sometimes because of the fear of telephone competition with the established government telegraph systems. The administrative record of the various state telephone systems varies greatly from country to country. In Switzerland, low rates and excellent service have

marked the administration from its inception. In France, on the other hand, it has been characterized throughout its operation by relatively poor service and high rates. The British Post Office, after lagging behind for many years, radically reorganized its telephone administration in the early nineteen-thirties, bringing quality and rate policy to a level unsurpassed anywhere.

Although the United States represents the outstanding example of almost wholly privately owned telephone and telegraph facilities, serious consideration has been given from time to time to the possibility of their transfer to the Post Office. The federal government operated the first telegraph service in 1843, but turned it over to private hands four years later. At intervals throughout the nineteenth century, various Postmasters General advocated government operation because of the close relationship between the various means of communication.

The strongest recommendation to this effect was put forward by President Wilson's Postmaster General, A. S. Burleson. In each of his eight annual reports, he advised that the Congress "declare a government monopoly over all telegraph, telephone, and radio communications and such other means for transmission of intelligence which may hereafter develop"; and "acquire by purchase at this time at appraised value the commercial telephone networks, except the farmer lines." His position was supported by an elaborate investigation in 1913, comparing the then existing services with those obtaining in Europe. The state systems on the Continent were found generally to provide both intensive use of existing facilities and substantially lower rates.[7] Various bills to effectuate these recommendations were debated in Congress in the following two years. In 1916, however, they were abandoned in favor of a measure giving the President the right to take over the telephone and telegraph services in wartime, but only for the period of the war. There is some reason to suppose that Postmaster General Burleson hoped to convert the temporary assumption of government control in 1918 into a permanent measure. A considerable degree of dissatisfaction was created by wartime government operation, however, largely owing to circumstances beyond the control of the operators. In the general reaction against governmental activity which followed the Armistice, any thought of a permanent public communications system was aban-

[7] *Government Ownership of Electrical Means of Communication,* S. Doc. 399, 63rd Cong., 2nd Sess., 1914.

doned. The suggestion has not been seriously repeated since that time.

Radio broadcasting is a further outstanding instance in which noneconomic motives have predominated in the widespread adoption of public enterprise. Unlike other communications services, broadcasting does not lend itself to unit by unit sale. It can be financed only by advertising or by a tax on radio set owners, which must perforce be collected by the government. The American solution has been widely regarded abroad as an example to be avoided at all costs. When regular broadcasting first became feasible, a European broadcast band roughly equal to that available to the United States (with a trifling portion allocated to Canada) had to be shared among twenty-three nations. With only a dozen major wave lengths at the most, the choice facing each country was not between public monopoly and private competition, but rather between public monopoly and private monopoly or "oligopoly." [8] The potential social and political uses and abuses of broadcasting were very far reaching and were probably decisive in determining the rejection of private monopoly. The fear in particular of political abuse, or of special interest propaganda with revolutionary implications, was often controlling.

In the totalitarian states the solution was simple and obvious: broadcasting was made an adjunct of the ministries of propaganda. The democratic nations were anxious to avoid domination of the radio by particular parties in power at a given time. Their typical solution, adopted in Great Britain, Republican Germany, two of the Scandinavian nations, Canada, South Africa, Australia, and elsewhere, was one or another form of corporate device, subject to ultimate public control but freed from the usual type of state intervention.[9]

[8] The fortunate situation of the United States in having exclusive control over a very large share of the entire available broadcast band would make practicable in this country an experiment, advocated in some circles, of a single government-owned chain of stations which might supplement the predominantly privately owned system. A number of cities, including notably New York, already own and operate radio stations.

[9] It is noteworthy that the only democratic nation to reverse this trend is New Zealand, where a public broadcasting corporation was abandoned in favor of operation by an ordinary department of state in 1936. It was argued by the Labor Party, then in power, that such control was essential in order to compensate for the complete absence of newspapers sympathetic with that party's views.

TRANSPORTATION

In terms of invested capital, by all odds the most important field of public enterprise lies in state railways. They are government owned and operated in Germany, Switzerland, Italy, the Austrian succession states, the Scandinavian and Baltic nations, the Balkan countries, Belgium, South Africa, Australia, New Zealand, Mexico, and a number of South American states. In France, where one of the major systems branching out from Paris has been state owned for decades, the former private railroads were combined in 1938 with this system into a unified national network. The Canadian Government owns one of the two major lines of the Dominion—the Canadian National—taken over to avoid bankruptcy of its previous private components and to maintain adequate transportation service in an enormous but sparsely settled region. Among the major nations, only Great Britain and the United States retain wholly private ownership. Our own federal government owns two small but significant lines outside of the United States proper—the Panama Railroad Company and the Alaska Railroad.

In the more densely settled European countries, the strategic motive was as important as any in the conversion of early private into publicly owned national railroad systems. Closely allied with this factor was the fear of discrimination and of excessive private power over the balance of geographical and industrial development, the dangers of which were so sharply demonstrated in the United States in the era before the Interstate Commerce Act. Public purchase of the Swiss lines was conditioned, in part, upon the desire to eliminate foreign capital from control of so vital a national asset. Bailing out the investors in lines overdeveloped in the first frenzy of railroad enthusiasm was also a factor in some instances. In the newer and unsettled nations, on the other hand, notably the British Dominions, governments undertook railroad construction from the start as an aid to systematic development of their territories. This action corresponded to the enormous subsidies granted to our own roads and was considered a more effective and economical method of pursuing similar objectives. As in this country, retrospective examination of railway development in the British Dominions suggests substantial overbuilding from the purely economic viewpoint. Whether the indirect benefits of rapid development compensate for direct monetary

losses on the railways is a difficult matter of judgment, defying definitive conclusion.

Other forms of transportation are also frequently conducted through public enterprise, although not to the extent found in railways. Docks and harbors, bridges and tunnels, inland barge transportation, ocean steamships in a few instances, and local rapid transport all afford examples. They include the Federal Barge Lines on the Mississippi and Warrior Rivers, operated by the government through the Inland Waterways Corporation. Long-distance road transportation of both freight and passengers remains, as a rule, in private hands, although in Germany many bus and truck lines were acquired by the Railway Corporation in the late nineteen-twenties. The trend toward increased municipal ownership of local transport systems has been very marked over recent years. Altered patterns of urban development, brought about through the automobile, have created problems of congestion necessitating unified and planned transportation systems for their solution. Public resistance to increased fares corresponding with increasing costs has also tended to displace private by public operation. The creation of the London Passenger Transport Board in 1933 and the unification of New York City's subway systems under municipal ownership in 1940 are outstanding examples of this trend.

ELECTRIC POWER

The most controversial contemporary borderline area of public enterprise is found in electric power and allied sources of energy. Municipal power supply has occupied a significant portion of the field in all countries since the beginning of central generating systems in the eighteen-eighties. With the development of long-distance transmission and the clear economies of large generating units, a number of governments have also established regional or national generating and transmission systems. Outstanding are the Ontario Hydro-electric Power Commission, the South African Electricity Supply Commission, the British Central Electricity Board, the Tennessee Valley Authority, the development of hydroelectric power in the Columbia Basin under the Bonneville Power Administration, and similar enterprises in Sweden and Switzerland. The great electricity combinations of Germany were developed by "mixed corporations" with stock participation and control shared by private investors,

consuming municipalities, various federal states, and the government of the Reich. Municipal ownership in gas works is also extensive in both Great Britain and Germany, although in the United States in 1937 only seven of our ninety-four largest cities were engaged in this business.

The basic motives for the extension of public enterprise to power have been discussed in Chapter 10. It will be noted that government operation on a scale larger than a single municipality has tended to concentrate in hydroelectric rather than steam-electric generation. Water-power resources have traditionally been subjected to closer public control by analogy with other basic natural resources, including forests and minerals. Effective long-range forestry management is exclusively a public function over the entire world. It is paralleled in varying degrees on the European continent with public operation in coal, potash, and other minerals.

BANKING, CREDIT, AND INSURANCE

In addition to central or bankers' banking, by its nature a public or quasi-public function, governments supply a wide range of services in the credit and insurance category. Public banking and insurance systems have attained their most extensive development in sectors of the economy which appear unattractive to private capital but which occupy a strategic position in the political framework. In the forefront of these sectors stands the farmer. Public agricultural credit has a long history on the European continent, taking the form both of special mortgage institutions supplying long-term loans and of state banks for short-term loans extending through the crop season. Similar organizations built up in the United States during the last three decades, and now co-ordinated under the Farm Credit Administration, are discussed in Chapter 5. Postal savings banks are another common device, affording a risk-free outlet for the small savings of lower income groups. Government insurance is a universal feature of social security programs and will be considered in that connection.[10]

Under the impact of financial dislocation or general economic depression, government credit is often employed on a large scale for salvage operations. Agencies created to handle immediate emergencies often find a lasting place in the economy, since important

[10] See Chapter 21.

debtors, individual and corporate, come to depend upon low-interest government financing for their continued existence. This was the case with the German *Reichs-Kredit-Gesellschaft,* established to cope with the runaway inflation of 1922 and remaining as a permanent element of the banking structure after the re-establishment of the mark on a firm basis. In the housing industry, where individual consumers' credit is an important factor, public financing has been used extensively in the United States, Great Britain, and Germany as a promotional device, designed to accelerate construction both for its own sake and as a means of reducing unemployment. The numerous federal credit agencies established in this country during the Great Depression, most of them public corporations in form, will be reviewed in the following chapter.

MISCELLANEOUS INDUSTRIES

In addition to these major areas of public enterprise, further examples within a predominantly private framework may be found in a great variety of industries. They appear in one nation or another in housing for low-income groups, armaments, iron and steel, aluminum, shipbuilding, and real estate. The development of large-scale public ownership in such fields was particularly far reaching in postwar central Europe. In Weimar Germany a giant publicly owned company, the *Vereinigte Industrie-Unternehmungen Aktiengesellschaft* (*Viag*), was established under the control of the Minister of Finance to administer the government interest, ranging from 30 to 100 per cent, in a great number of such businesses. A similar holding company, the *Preussische Bergwerks und Hütten-Aktiengesellschaft* (*Preussag*), was set up in 1920 by the Prussian Government to administer its interests in the mining and smelting field. Under the terms of the United States Housing Act of 1937, Congress adopted as a permanent policy the subsidization of slum clearance and housing construction for low-income groups. The passage of this measure was motivated by the desire to provide employment and stimulate heavy industry, as well as by the need for low-cost housing. Project construction and operation are administered wholly by local authorities, aided by long-term federal loans at low interest rates and grants toward rent reductions for extremely low-income tenants.

From this brief survey of the scope of modern public enterprise, it is evident that the characteristic American scheme of private operation and government regulation for public utilities is practiced only

rarely elsewhere, even in countries sharing our ideological traditions. Economic and noneconomic motives have been linked together in producing this pattern. The importance of these industries to an industrialized economy, the power over national development given by their control, and in many cases their military significance for the very national existence itself, are the controlling factors leading to government operation. As underlying technical necessities have created public responsibility for guaranteeing the provision of such services in any case, governments have often found it more convenient to supply them directly rather than to depend for their supply upon regulated private management.

3. The Significance of Organizational Forms

The growth of public enterprise has necessarily carried with it concomitant reactions upon substantial private interests. Where some utilities are privately owned and others publicly, the threat of extension of the public sector is always vividly present in the minds of the private entrepreneurs. While the history of transfer from private to public hands indicates a great preponderance of over- rather than undercompensation, the prospect of purchase or condemnation is not often viewed with pleasure by the private owners. Controversy over the proper functions of government is consequently centered to a large extent about the alleged superiority or inferiority of public enterprise in the public utility field. Not only is there a sizable volume of general literature seeking to establish the merits or demerits of government ownership from first principles, but each outstanding instance of public enterprise has also brought in its train a host of laudatory and derogatory analyses.

Central to the controversy is the question of the administrative forms under which public enterprise is conducted. The mere transfer of ownership from private to public hands is of relatively little significance. It excludes private profits; it avoids the friction of private operators and public regulators. It does not in itself guarantee efficient operation, service of the public interest, or freedom from abuse. The leading general arguments against public enterprise are focused about its supposed defects in administration: in particular, patronage and political interference in personnel; unsatisfactory financial practices associated with government accounting when applied to business undertakings; the traditional lack of initiative of bureaucracy; and

the interference of special interest groups with operating policy. The validity of such criticisms will vary in large degree with the effectiveness of a country's public administrative machinery as a whole. The Prussian railway system, at the end of the nineteenth century, was universally recognized as an example of efficient management which returned no inconsiderable profit to the state. The French state railways, like the telephones, were by comparison very poorly administered. A well-selected civil service enjoying high public esteem and a long-established tradition of devotion to the public welfare is naturally a superior administrative instrument to a body of public officials chosen by patronage and occupying a low status in the social order.

Apart from the merits of a given country's civil service organization as a whole, experience indicates that the traditional forms of public administration are ill suited to the management of governmental economic enterprise. New government functions are naturally assimilated at their inception to tried administrative procedures. The inherent differentiation of public enterprise from traditional state functions, however, suggests the desirability of special machinery for the purpose. Only after consideration and appraisal of such distinctive administrative forms can public enterprise in practice be properly evaluated.

4. Departmental Management

The characteristic administrative device of modern governments, democratic and otherwise, is the government department or ministry of state. This form has developed in various countries with remarkable parallelism. Executive functions are generally divided into broad areas ranging from one to two dozen in number, each supervised by a single person. The various heads compose together a collegial co-ordinating cabinet, supervised by the chief executive. Departments are further functionally subdivided under bureau chiefs or assistant ministers, each with a staff and line organization. While security of tenure and methods of appointment vary greatly, the desirability of an established boundary line between policy-making officials and permanent subordinates is widely recognized. In democracies, only the department heads and their immediate assistants are replaced with shifts in party control, the head alone being changed in some instances. Local governments are provided with corresponding administrative organs, although there is greater variety in their

detailed form and less widespread provision for co-ordination. Departments under the executive control of a mayor or city manager form the common American type, while in the European democracies the active administrators are ordinarily controlled by specialized committees of popularly elected local councils.

Such administrative machinery is often applied to the operation of public enterprise as well as to other governmental functions. Before the first World War the preponderance of government-owned businesses was controlled in this manner. The advantages of departmental organization are by no means inconsiderable. Regular cabinet meetings and a uniform relationship to the chief executive provide for constant unification and consistent application of over-all general policy. Responsibility is focused upon the single department head. Channels of authority and responsibility are well defined. Through appropriate hierarchical arrangements, decisions may be graded by importance and systematically distributed among the suitable levels of administration. Where the cabinet is an executive committee of the political majority in the legislature, as under the parliamentary system, it is a direct channel for legislative control through the departmental heads, implemented in part by the system of parliamentary questions or interpellations.

Somewhat similar control is exercised in the United States through the annual review of appropriation requests by subcommittees of the House of Representatives Appropriations Committee. Financial requirements are co-ordinated through one or another form of centralized budget and detailed expenditures may be scrutinized by the general auditing officers. Such an administrative structure is designed to provide the fundamentals of good management. In the words of the President's Committee on Administrative Management:

> canons of efficiency require the establishment of a responsible and effective chief executive as the center of energy, direction, and administrative management; the systematic organization of all activities in the hands of a qualified personnel under the direction of the chief executive; and, to aid him in this, the establishment of appropriate managerial and staff agencies. There must be also provision for planning, a complete fiscal system, and means for holding the Executive accountable for his program.[11]

[11] *Report of the President's Committee on Administrative Management*, 1937, p. 3.

In large measure, the advantages of departmental management in general administration apply equally to the administration of public enterprise. Even where complete fiscal independence, with neither government subsidy nor government profit, is desired, the operation of a public business cannot be wholly divorced from wider considerations of public policy. The effects of transportation rates upon differential regional development, for example, which have entailed so much controversy in the process of public regulation of the private industry, are not eliminated merely by the substitution of public for private ownership. The very prevalence of noneconomic motives in occasioning the introduction of public enterprise suggests the necessity for maintaining a degree of control by the general policy-determining agencies of the nation, in order to ensure the satisfaction of these motives after public operation is undertaken. Where special subsidies or public guarantees of financial solvency are involved, as is frequently the case, the general treasury will rightly demand a degree of influence upon the operation of the business commensurate with its responsibility as banker.

Considerations of this sort might dictate the application of well-tested administrative forms to public enterprise without substantial modification. Yet the cumulative experience of nation after nation indicates that the peculiar characteristics of this type of activity are not adequately recognized by departmental administration. Application of the traditional forms, in fact, entails those very defects in operating efficiency which are traditionally associated with government ownership and operation in general. In all administration, public and private, some compromise must be found between integrated control of policy on the one hand and freedom of operation for day-to-day managers on the other. Public enterprise appears to require special emphasis upon the latter desideratum.

The major weaknesses of departmental management applied to public enterprise lie in the realms of organization, personnel, finance, and psychology. The major positive dangers are to be found in one or another type of so-called "political influence." An organization selling goods or services bears a relation to the general public quite different in nature from one administering governmental functions of the traditional variety. It must adapt itself more readily to unpredictable fluctuations in market conditions. Rapidity of decision, ability to take advantage of favorable opportunities, and recognition

of short-run commercial considerations may often be more vital to efficient enterprise than the rigid devotion to strict legality, or even legalism, which necessarily characterizes the ordinary bureau. A degree of secrecy is often warranted in commercial operations, moreover, in order to avoid private profiteering. While obtainable in some circumstances through departmental management, it is achieved more readily with an autonomous form of organization. The very responsibility of the department head in the public eye will often militate against the degree of devolution essential to administrative flexibility. A former British Postmaster General has indicated that the system of parliamentary questions, while a highly desirable technique of public control over bureaucratic invasions of individual rights, tends to push the process of decision toward the higher levels of the administrative hierarchy.[12] Lesser officials are loath to exercise imagination and discretion, knowing that strict adherence to routine will avoid the danger of parliamentary representations as to their conduct. Yet in a commercial context flexibility and decentralization of authority are prime necessities for successful administration.

In the second place, personnel arrangements developed for recruitment and promotion of civil servants are also frequently ill devised to fit the needs of commercial administration. Routine examinations which serve well enough for minor clerical positions will not enlist the talent and capacity required in the higher ranks—a factor recognized in the differentiation in types of examinations among the various classes of the British civil service. In general, public service affords relatively high salaries in the low ranges, but relatively low salaries in the upper ranges, depending upon security and perhaps prestige for added compensation. Rapid promotion is rarely the reward for special merit, since a minimum level of morale is most easily maintained through seniority promotions. The faithful completion of set tasks is often valued in civil service organizations more highly than imagination in devising, or initiative in experimenting with, new methods of operation. Many of the disadvantages attaching to governmental personnel arrangements apply in large measure to the organization of all large institutions. Experience indicates, however, that effective commercial administration is more readily achieved with more flexible rewards and less security than appear desirable in the ordinary public service.

[12] C. R. Attlee, "The Bridgeman Committee Report," 10 *Public Administration* 352, 355 (October, 1932).

Such considerations apply *a fortiori* to a poorly organized civil service or to public personnel arrangements entirely lacking in civil service methods. Patronage and nepotism are evidently unsatisfactory methods of recruitment. Their common use in private corporations is, in theory at least, ultimately checked by the requirements of solvency in a competitive business world, and in monopolistic enterprises by stockholder pressure for efficient operation. The success of well-organized civil services in eliminating such methods suggests that civil service techniques should not be wholly abandoned in the operation of public enterprise. But they require substantial modification to fit the special conditions of business management.

Financial arrangements employed in ordinary governmental practice, thirdly, are based upon considerations utterly different from those applying to public enterprises. Primary and often exclusive emphasis is laid by government accounting upon the cash account. A well-organized system provides a detailed check upon each penny received and each penny expended. Public financial controls are directed toward two central objectives: avoidance of corruption and insurance that no expenditure is made without appropriate legislative authority. Accounting methods rarely distinguish between capital expenditures and expenditures on revenue account. The attitude of supervising officials in enforcing rigid rules regarding competitive bidding, expense accounts, and the like, whether they be in the British Treasury or the American General Accounting Office, is frequently one of parsimony rather than economy.

Under departmental management revenues from an enterprise flow into the general treasury and expenses are paid out of the general treasury. The real financial position, as opposed to the merely superficial annual cash balance, is often impossible to determine. Variation of capital expenditure from year to year may be entirely justified by particular needs, yet in years of heavy expenditure the financial record will appear poor despite the usefulness of the resulting equipment over a considerable period in the future. Adequate financial appraisal of public enterprises, no less than of their private counterparts, requires accounting on a commercial basis. Flexibility in general administration, moreover, demands in the financial field a degree of freedom from the rigidity of ordinary budgetary and accounting controls.

The psychological connotations of departmental organization, finally, are not conducive to enthusiastic and imaginative administra-

tion of an economic enterprise. The very word "bureau" suggests a "bureaucratic" attitude, one of slow and methodical routine, replete with checks and counterchecks, hampered by red tape, and delayed by interminable series of reviews. The spirit which favors innovation, promotion, and even salesmanship may be developed in an ordinary civil service agency, but the process is a struggle against ponderous tradition. The very creation of special administrative forms for public enterprises puts the managers on their mettle, at least during the initial stages, in order to prove the worth of the new agencies.

To these typical weaknesses of departmental management when applied to public enterprise there must be added a type of positive danger suggested by the expression "political influence." In the sense of policy formation in accordance with broader considerations, noneconomic or economic, political influence is, of course, highly desirable. Depending upon the political structure of the system as a whole, however, special interests quite unrelated to broad policy considerations may find channels for influencing administrative decisions in clearly undesirable manners.[13] Under American conditions special sectional pressures are particularly likely to carry weight quite unwarranted by their relative importance in the economy as a whole.

Despite the undeniable connection between the management of public enterprises and considerations of broader policy, moreover, their primary concern is the efficient supply of goods and services. In most respects this function bears little or no relation to the issues dividing political parties. Frequent turnover in their top managerial positions in accordance with party fluctuations, therefore, is likely to be a

[13] Adam Smith remarked upon this possibility in the context of a semifeudal aristocratic society in the following terms:

"When high roads, bridges, canals, etc., are in this manner [i. e., through tolls] made and supported by the commerce which is carried on by means of them, they can be made only where that commerce requires them, and consequently where it is proper to make them. Their expense, too, their grandeur and magnificence, must be suited to what that commerce can afford to pay. They must be made consequently as it is proper to make them. A magnificent high road cannot be made through a desert country where there is little or no commerce, or merely because it happens to lead to the country villa of the intendant of the province, or to that of some great lord to whom the intendant finds it convenient to make his court. A great bridge cannot be thrown over a river at a place where nobody passes, or merely to embellish the view from the windows of a neighbouring palace: things which sometimes happen, in countries where works of this kind are carried on by any other revenue than that which they themselves are capable of affording."

The Wealth of Nations (Cannan ed., 1904), Vol. II, p. 216.

serious impediment to effective management. Continental parliamentary systems, like the French and (before 1922) the Italian, involving numerous parties and relatively unstable coalition cabinets, tend to produce particularly frequent shifts in cabinet membership. Even in the American system, where continuity of executive leadership for at least four years is assured, the tendency to replace not merely the cabinet members themselves, but also a considerable number of other high officials, with a change in Administration presents serious disadvantages for departmental management. Where the roster of a public enterprise includes a great number of employees —the 800,000 workers of the German Railway Corporation, representing with their families 4 per cent of the nation's population, afford a striking example—the political pressure of this group may be employed to obtain disproportionate privileges as compared with the remainder of the working class. If patronage is a recognized element of the public personnel recruitment system, efficiency will be seriously impaired. Control on behalf of the people must be maintained over public enterprise as over all other forms of public activity. The peculiar liability to undesirable political interference, however, is a further influential factor favoring a greater degree of autonomy than can be established within the traditional framework of departmental management.

The most extensive experience with departmental management of important public enterprises is to be found in the European railways. When government ownership was first undertaken, direct control by the appropriate cabinet minister, whether a special minister of transport, a minister of public works, or a minister of posts, railways, telephones, and telegraphs, was the general custom. In nation after nation, the typical defects of departmental management were revealed in successive stages, leading in the twentieth century to a widespread and almost universal movement toward autonomy. Only the Prussian system was generally viewed as a successful example of departmental management; this exception was widely attributed to the unusual constitutional framework within which the Prussian administration operated, granting the executive almost complete independence from political control. The undemocratic composition of the Prussian Diet was itself an assurance against party fluctuations of any magnitude.

Elsewhere, charges of political abuse were ubiquitous and evidences of managerial inefficiency conclusive. The Belgian system, before 1926,

may serve as a concrete example. Railway finances were confused with ordinary state finances; administrative control was under the immediate direction of a politically appointed cabinet minister; and partisan considerations played an important role in the selection of personnel. An apparent padding of the volume of employment, amounting in 1914 to over nineteen workers per kilometer as compared with fewer than thirteen on the neighboring lines of the French *Chemin de Fer du Nord,* was ascribed by opponents of the party then in power to a desire to increase the latter's electoral support. It was also charged that special low workmen's commuting fares were designed primarily to keep workers from living in the large cities, where they might come under the influence of opposition parties with strong urban organizations. In 1912, a play was made for employees' voting support through a retroactive wage increase granted on the very eve of a general election.

While these abuses were probably more far reaching than the general rule, they were paralleled in greater or less extent in other countries. State railway managers, sincerely anxious to set a record of operating efficiency, found themselves continuously hampered, squeezed between special interest pressures pleading for reduced rates on the one hand, and pressures from labor and manufacturers of railway supplies tending toward increased costs on the other. The confusion of railroad accounts with general state finances, together with variations in circumstances from country to country, make valid comparative appraisals difficult. But the unfavorable conclusions of careful students on prewar departmental management of government railways appear to be fully supported by the evidence.

Similar criticisms have from time to time been directed toward postal administrations, but in lesser degree by virtue of the simpler managerial problems and the predominance of routine operations. The desirability of commercial methods has been demonstrated particularly strongly for telephone and telegraph services, but even in the strictly postal field the peculiar needs of public enterprise have made themselves felt.

An examination into the operating methods of the United States Post Office Department was undertaken in 1907 under the auspices of a joint Congressional Commission, after serious scandals a few years earlier had led to a number of expulsions from the service and criminal convictions. The Commission engaged two outstanding firms of certified accountants to investigate the Department and

recommend improvements. While not suggesting the abandonment of ultimate control by a Cabinet officer, the accountants proposed that the offices of First, Second, Third, and Fourth Assistant Postmaster General be abolished and that "a director of posts be appointed at a salary sufficient to attract the best administrative talent in the country, and that he be given sole charge of the operations of the Department and Service, subject only to the control in matters of policy of the Postmaster General as a Cabinet officer." [14] They also recommended the establishment of a promotion system based on merit alone and the adoption of some scheme for retiring many of the older employees "who are retained at present for purely humanitarian reasons and the value of whose services is infinitesimal." Emphasis was also laid upon the need for a proper accounting system in order to show accurately all the costs and all the revenues properly attributable to the postal service. The major reforms were not adopted, but the investigation resulted in substantial improvements in personnel and in various details of operating and accounting practice.

5. The Trend Toward Autonomy

As experience with operation of large-scale public enterprise expanded during the nineteenth century, and evidence multiplied that its special characteristics required corresponding special administrative devices, proposals were made with increasing frequency that such operations be separated, to some extent, from the ordinary controls imposed upon government departments. During the occasional lapses in the chronic dispute over the advantages of government operation as against private operation, voices were raised to suggest that an effort be made to obtain the advantages of both. A few tentative experiments in this direction were made before the first World War. The movement toward autonomy reached its full development, however, only with the widespread adoption during the nineteen-twenties of incorporation under government ownership as the typical administrative form for public enterprise.

The crystallization of sentiment favoring autonomy is illustrated by the remarks of Sir William Acworth, the leading British authority on railway administration, at the conclusion of his survey of government-operated railways in 1917:

[14] *Preliminary Report of Joint Commission on Business Methods of the Post Office Department and Postal Service,* S. Rept. 201, 60th Cong., 1st Sess. (1908), p. 121.

> Some day perhaps [he wrote], having learned wisdom by experience, a Parliament and a people may recognize that management for the people is not necessarily management by the people; that there are other branches of government, besides the judicial branch, unsuited for popular interference; and may establish a permanent State railway organization, with its own board of directors, with its own separate budget, and entirely independent of Parliamentary control, but controlled like any private company by a judicially minded commission, required also like a private company to earn a dividend for its stockholders, the people. And then a main objection to Government railways in a democratic State will have lost its force. But hitherto no Parliament and no people have recognized this fact, even though it stands out abundantly clear on the pages of railway history.[15]

Certain limited gropings toward autonomy had, in fact, been started before this time. An Italian railway act of 1907 established an ostensibly "autonomous administration" under the general supervision of the minister of public works, with a permanent general director as the chief executive officer, and a special supervisory council combining railway officers, high civil servants, and certain other members with special technical administrative qualifications. Railway finances were separated from those of the state. The law looked to the enterprise to be economically self-supporting. While neither in administrative organization, personnel, nor finances was the divorce from general administration as complete as that characterizing modern public corporations, the Italian statute was recognized as a significant step in this direction. It was characteristically reversed by the Fascist Party in 1924, not long after the seizure of power by Mussolini.

Public railway administration in other European nations was radically altered after the first World War with a view to providing increased autonomy. In almost every case the full measure of incorporation was applied. The outstanding instance of the German Railway Corporation, the largest single public enterprise in the world, will be described in the following chapter. In some other areas, notably postal administration, a lesser degree of autonomy has been the rule. This is the case with the reform of the German Post Office adopted in 1924. Section one of the National Postal Finance Act of that year established the post and telegraph service as "an independent under-

[15] W. M. Acworth, *Historical Sketch of Government Ownership of Railroads in Foreign Countries*, p. 63.

taking under the name *Deutsche Reichspost,* to be administered by the Postmaster General with the co-operation of an administrative council, in accordance with this law." Postal property was segregated from other state property and made subject exclusively to claims against the Post Office. The personnel retained civil service status in the full sense, but financial independence was assured and a degree of administrative autonomy was provided by placing the administrative council as a buffer between the cabinet and the operating officials. A fixed proportion of postal revenue was to be turned over to the general treasury each year, the remainder being applied solely to operation and improvement of the service. Capital commitments could be made on the basis of postal credit alone. The ordinary financial checks of the minister of finance, however, were maintained in large measure.

A somewhat similar reform was carried through in the British Post Office in 1933, after drastic criticism of postal administration by a Member of Parliament based upon four and one half years' experience as Assistant Postmaster General. An official Committee of Enquiry, reporting in 1932, rejected his proposals for a public corporation, but recommended increased financial autonomy and administrative decentralization, while retaining Parliamentary control through the Postmaster General.[16] A separate Post Office fund was established, out of which a fixed annual amount was paid to the Treasury as profit on the postal undertaking. The management of telephones and telegraphs was placed under a separate unit; increased flexibility was given to the personnel arrangements to correspond with the special needs of the Post Office as contrasted with the remainder of the civil service; and a functional board was established under the Postmaster General to supervise the administration as a whole. While it was widely felt that the corporate form would have been adopted at least for telephones and telegraphs if government management had been undertaken for the first time in 1933, the compromise arrangement was viewed as reasonably satisfactory.

Viewing the private corporation in its incipiency, Adam Smith, in 1776, had little confidence that this form of organization could administer effectively any but routine operations. "The directors of such companies," he said, "being the managers rather of other people's money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners

[16] Wolmer, *Post Office Reform* (1932); *Report of the Committee of Enquiry on the Post Office,* 1932, Cmd. 4149 of 1932.

in a private copartnery frequently watch over their own."[17] Banking, insurance, canal operations, and water supply, all of which required large amounts of capital and little imagination in management, appeared to him to set the limits to workable corporate enterprise. The experience of the subsequent century and a half demonstrates the folly of so sweeping a generalization. With the development of autonomous forms for public enterprises, a similar revision of generalizations concerning government ownership and operation may now be necessary. As opportunities are removed for the exercise of the pernicious varieties of political influence and as a degree of financial and administrative independence is secured, incentive and opportunity for successful administration may be provided no less for public than for private corporations. The typical, characteristic modern expression of the autonomy movement, therefore—the incorporated public enterprise—deserves special attention as an attempt to eliminate the defects both of private ownership under rigid government control and of government ownership and operation in the traditional manner.

[17] Adam Smith, *The Wealth of Nations* (Cannan ed.), Vol. II, p. 233.

Chapter Nineteen. THE PUBLIC CORPORATION

The public corporation is the fullest embodiment of the world-wide trend during the twentieth century toward autonomy in the operation of public enterprise. The term includes a multitude of administrative devices, all enjoying a degree of freedom from direct political control and deriving their organizational character from the forms developed during the nineteenth century for the administration of large-scale private corporations. Formal legal incorporation, although universally applied to such organizations for purposes of convenience and to emphasize their autonomy, is of less significance than the substantive independence with which they are endowed.

Conversion of public enterprises from departmental management into public corporations, as well as the employment of the device for newly established government operations, reached its most impressive lengths in the post-World War I epoch. Between 1923 and 1926, railroad administrations were reconstituted in this manner in Switzerland, Austria, Germany, Hungary, Rumania, Belgium, Poland, and Greece. Almost the entire range of miscellaneous government businesses set up on the European continent in that period took the corporate form. In Great Britain, where a special type of corporation for harbor undertakings had been used at several of the large ports for many decades, the form was utilized for all the important new public enterprises after the war, including notably the Central Electricity Board, the British Broadcasting Corporation, and the London Passenger Transport Board.[1] When the Popular Front government

[1] For a brief description of the British Broadcasting Corporation and the Central Electricity Board see below, pp. 695–703.

drew up plans for the nationalization of the French railway, airplane, and munitions industries, it looked upon the public corporation as a normal administrative device for these purposes. Even in Fascist and Communist nations, where removal from political influence is not an objective of public policy, the desirability of administrative freedom has led to a limited use of autonomous enterprise, as witness the state trusts of the U.S.S.R. between 1921 and 1928 and the various "institutes" of Fascist Italy. On the whole, however, the overwhelming consideration of integrated and centralized party control has led in the totalitarian nations to reversal, rather than continuation, of the trend.

American experience with public corporations, barring some notable early experiments like the First and Second Banks of the United States, is primarily a product of two troubled periods of our economic history—the first World War and the Great Depression.[2] Federal World War corporations included the Emergency Fleet Corporation of the United States Shipping Board, the United States Grain Corporation and the Sugar Equalization Board of the Food Administration, the War Finance Corporation, the United States Housing Corporation, the United States Spruce Production Corporation, and the Russian Bureau, Inc. In dealing with the pressing problems entailed by the depression of 1929, the federal government created new public corporations almost indiscriminately. The largest of them all, the Reconstruction Finance Corporation, was established in 1932. It was followed under the New Deal by a host of others.[3] In a few instances

[2] Portions of the emergency defense program begun in 1940 are similarly being carried on through newly created public corporations. Between June and November, 1940, five new corporations were established by the Reconstruction Finance Corporation for defense purposes. The Rubber Reserve Company, capitalized at $5,000,000, was charged with acquiring and carrying a reserve supply of crude rubber. The Metals Reserve Company, capitalized at $5,000,000, was given similar duties with respect to critical and strategic materials, especially tin and manganese. The Defense Plant Corporation, capitalized at $5,000,000, was to acquire land, plant, and equipment for the manufacture of military supplies and to arrange for their manufacture by lease, license, or otherwise (if necessary, engaging in their manufacture itself). The Defense Supplies Corporation, capitalized at $5,000,000, was to acquire and carry reserves of strategic or critical materials or supplies needed for the defense program. The Defense Homes Corporation, finally, capitalized at $10,000,000, was to assist in providing necessary housing in connection with War and Navy Department activities.

[3] In order of their creation, they were the Tennessee Valley Authority; the Home Owners' Loan Corporation; the Production Credit Corporation, the system of Banks for Farm Co-operatives, and the Federal Farm Mortgage Corporation of the Farm Credit Administration; the Federal Deposit Insurance Corporation; the Federal Surplus

the corporate form proved in practice to have no substantial advantages; the activities were soon absorbed into larger agencies and the corporations lapsed.

Two important federal corporations originating in nonemergency periods are the Panama Railroad Company, acquired from private interests in 1904, and the Inland Waterways Corporation, established in 1924. Together with the Tennessee Valley Authority and the United States Housing Authority, these agencies were created as semipermanent instrumentalities of government rather than temporary organizations to accomplish short-run objectives and to be liquidated at the end of an emergency. A number of the others, however, notably the Reconstruction Finance Corporation, also bid fair to become permanent features of our federal administration.

In the states and municipalities the trend toward incorporation for public enterprises has been less marked, although a number of notable examples are at hand. The device has proved useful for regional administration in areas not covered by pre-existing political units, particularly metropolitan areas larger than existing counties or cities. The widespread development of public utility districts, irrigation districts, and other special local authorities, encouraged in considerable degree by the Public Works Administration loan and grant policy, is a similar phenomenon, although such units share in part the character both of traditional local governmental authorities and of public corporations proper. In a few instances, like the Port of New York Authority,[4] the form has been used under interstate compact to construct and operate public projects affecting two or more states.

Relief Corporation; the Commodity Credit Corporation; the Public Works Emergency Housing Corporation; the Federal Subsistence Homesteads Corporation; the Electric Home and Farm Authority, Inc.; The Tennessee Valley Associated Co-operatives; the Public Works Emergency Leasing Corporation; the Export-Import Bank of Washington; the Federal Savings and Loan Insurance Corporation; Federal Prison Industries, Inc.; the RFC Mortgage Company; the Disaster Loan Corporation; the Farmers' Home Corporation; the United States Housing Authority; the Federal National Mortgage Association; and the Federal Crop Insurance Corporation.

[4] The Port of New York Authority, a public corporation, was created under an interstate compact of 1921 between the states of New York and New Jersey. It is administered by a Board of twelve Commissioners, six from each state. The Commissioners are appointed by the Governors and Senates of the respective states for six-year terms, and serve without pay. Executive operations are under the supervision of a full-time general manager.

The Authority is charged with the responsibility of developing terminal and transportation facilities within the New York Port District and representing the interests

Use of the public corporation permits an almost infinite degree of flexibility in internal organization and in the type of relation to the central organs of government. It makes possible varying degrees of autonomy in four major respects: political autonomy (freedom from legislative and other popular controls); administrative autonomy (freedom from ordinary executive controls); autonomy in personnel (freedom from ordinary civil service requirements); and financial autonomy (freedom both from dependence upon the legislature for funds and from ordinary budgetary and auditing controls). In internal organization, it may carry devolution even to the extent of acting merely as a holding company for subordinate operations. The divorce from centralized direction is never complete. Such direction may be exerted to any degree desirable in any of the four major categories of autonomy, and examples can be found for almost every possible combination of control mechanisms.

General legislative and executive supervision is ordinarily maintained through appointment of corporation directors and requirements of approval for major policy decisions. The formal analogy to the position of private stockholders is close, but practical control is

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of the Port before the Interstate Commerce Commission and the United States Maritime Commission. It promotes port development in accordance with a comprehensive plan adopted by the two legislatures in 1922 and subsequently revised from time to time to meet changing needs. Its most striking accomplishments have been in the field of interstate vehicular facilities; they include the George Washington, Arthur Kill, and Bayonne Bridges, and the Lincoln Tunnel. Operation and maintenance of the Holland Tunnel was transferred to the Authority in 1930. The Authority also constructed Inland Freight Terminal No. 1 in 1932 to improve the handling of freight among eight major trunk-line railroads on Manhattan Island. The Authority does not own piers or other similar harbor facilities.

Port Authority finances are on an independent basis. The great bulk of the funds required for the construction projects, amounting to almost $240,000,000 by the end of 1939, has been obtained through the flotation of fixed-interest bonds on the open market. Operating revenue is derived from tolls charged for the use of the vehicular facilities. Although the bonds are not guaranteed by the states, the Authority's credit has ranked very high in the bond markets. Early in its career, the Authority was assisted in the initial establishment of a high credit rating through advances from the states, subject to ultimate repayment and in large part already repaid. In addition, grants of about $6,400,000 were received from the federal government and the two interested states in aid of construction of the Lincoln Tunnel and the George Washington Bridge.

On the whole, the Port of New York Authority presents an outstandingly successful example of public enterprise carried on through interstate co-operation.

more effective than that of the legal owners of typical modern corporations.[5] The major policy areas of legislative or administrative intervention in corporate operations almost always include alterations in price or rate levels, large-scale borrowing, and new capital construction. Beyond this point, controls may be made as extensive as special circumstances warrant.

Civil service recruitment, promotion, and tenure are often suspended or eliminated for public corporations, although in a number of notable instances, including the German railways, they have been maintained virtually intact. Separation from the civil service creates opportunities for experimentation in recruitment techniques to suit the particular needs of given services; both the Port of London Authority and the Tennessee Valley Authority have made use of their freedom in this respect with excellent results. While extremely high salaries for the upper officers are generally frowned upon in the public service in general, divorce from the ordinary administration permits a relatively flexible system of financial rewards and promotion schedules.

The autonomy provided by the use of the corporate form is of greatest importance in the realm of finance. Through separation from the general treasury and the requirement that the enterprises be economically self-supporting, corporate managers may be stimulated to high standards of commercial efficiency. Realization that losses will not be automatically made up from the public purse and that profits may be employed for improvement of the service directly under their control both play important roles in this connection. Where subsidy is desirable as a matter of public policy or the state desires to obtain a profit from the undertaking, financial autonomy in operations may still be retained through agreements for the transfer of fixed sums either to or from the corporation. Complete autonomy is well illustrated by the statutory provisions for the Swiss Federal Railways. After payment of operating costs, interest and amortization charges, and allowance for maintenance and depreciation, they must place any remaining revenue in a reserve fund for new development. If

[5] Exceptional appointment arrangements apply to the Port of London Authority and certain other British harbor corporations, the bulk of the directors being chosen by shipowners and merchants. This organization follows the pattern of a consumers' co-operative, depending for its incentives upon the direct interest of port users in maintaining satisfactory service at reasonable cost.

this amount exceeds 8 per cent of the gross revenue for five successive years, the general level of rates must be reduced.

Only in rare instances is financial autonomy carried into the field of borrowing. Government subscription to the original issue of common stock may supply a substantial part of the total capital. Such further borrowing as is necessary carries in the great majority of cases a treasury guarantee of both interest and principal, usually with special control powers by the treasury in case it is called upon to make good a default. The British public corporations and the Port of New York Authority, which borrow on their own credit without government guarantee and possess no common stock, are outstanding exceptions. In recent years local public enterprises in the United States have also tended to make increasing use of revenue bonds, issued solely on the security of the income from the enterprise and completely dissociated from local government tax resources. Since one of the most significant basic economic advantages of public over private enterprise lies in the lower interest rates made possible by the use of general government credit, and since in some instances it is precisely this factor which makes economic self-sufficiency possible, these advantages are ordinarily felt to outweigh the limitations on autonomy necessarily associated with government guarantee.

In so far as operating revenue is provided directly by the sale of services, and capital by the sale of securities, government corporations are relieved from ordinary budgetary and legislative control over their expenditures. The rigid fiscal audit applied to general government agencies is also commonly relaxed to some degree, and in a few cases displaced in its entirety through outside audit by private accountants. The recent history of American public corporations is marked by bitter conflicts with the General Accounting Office over the extent of freedom from its rules regulating the disbursement of public funds. Where an enterprise is supported entirely by its own revenues, flexibility in purchasing methods and in details of expenditures, commensurate with the responsibility of the corporation managers, appears to ensure greater over-all efficiency than rigid adherence to general government standards. Public corporation accounting techniques, moreover, are usually modeled upon business practice in the corresponding field of operations. Not only is commercial accounting designed to afford a more realistic appreciation of the actual economic condition of such enterprises; it also permits of valid comparisons, when desirable, with private business.

1. The Public Corporation Abroad

The richness of European experience in this field gives special significance to outstanding foreign public corporations as a background against which to set more recent American developments. The European forms have been developed through decades of experimentation. Their successes and defects may be expected to afford significant lessons for the United States. We shall review briefly, therefore, four leading German and British examples: the German Railway Corporation, the German United Industries Corporation, the British Broadcasting Corporation, and the British Central Electricity Board.

THE GERMAN RAILWAY CORPORATION (DEUTSCHE REICHSBAHNGESELLSCHAFT)

Despite the successful operating record of various German state railway systems before the first World War, particularly in Prussia, their organization was faced with persistent criticism along two major lines. Demand for unification into a single federal system was the more pressing of the two, but it was accompanied by a substantial and increasing weight of sentiment for autonomous administration. Bismarck's effort to establish a unified Reich system in 1876 failed in the face of opposition from the states of southern Germany, which feared further centralization and a strengthening of Prussian influence. During the War of 1914–18 centralized operation was enforced as a matter of military necessity. The termination of hostilities found the lines in relatively poor physical shape, owing to postponement of maintenance and replacement, and facing severe economic difficulties because of the altered price and wage structure. With the revolution of 1918, an opportunity was created for complete reconstitution of the organization.

Railway unification under the central government was provided specifically by the Weimar Constitution. It required their administration "as an autonomous economic enterprise, which is to bear its own costs, including interest and debt amortization, and to establish a railway reserve fund." Unification was carried through at once, but general financial conditions made heavy state subsidies inevitable for the time being. Creation of an autonomous regime was consequently postponed until 1924, administration being carried on for the time being through an ordinary government department. With the stabili-

zation of the mark in 1923, treasury subsidies came to an end. A statute was passed for the creation of a semiautonomous organization, to be called the *Deutsche Reichsbahn.* Only a limited administrative separation from the state was envisaged, since the Director General was also to hold cabinet office as Minister of Transport. Before the new organization could demonstrate its feasibility, however, it was further modified in accordance with the Dawes Plan and directly tied to the payment of reparations. The *Deutsche Reichsbahngesellschaft,* or German Railway Corporation, was established at the end of 1924 to implement this plan.

The new organization divided central authority between a supervisory administrative council (*Verwaltungsrat*) and an executive council (*Vorstand*). In the former organ, the principle of autonomy was combined with a degree of foreign participation, designed to make certain that the designated reparations payments would be made. Of its eighteen members, nine were nominated by the Reich government (including up to four in its capacity as holder of preferred stock) and nine by a foreign reparations trustee, including at least four foreigners. The number was, in fact, never made more than four, and with the revision of the reparations settlement under the Young Plan in 1930 this feature of the organization was abandoned. The corporation was thenceforth purely German. Members of the administrative council were required to have had experience in the nation's economic life or to be railroad experts; they held office for terms of six years. Federal and state legislators and cabinet members were excluded. The administrative council was entrusted with general financial supervision of the undertaking.

Operations were controlled by the executive council, appointed by the administrative council with the approval of the Reich President and consisting of a Director General with several assistant administrators. Practical continuity of operating policy was provided by the retention of a single individual, Julius Dorpmüller, as Director General throughout the corporation's existence, including the period since the assumption of power by the National Socialists. Railway accounts followed the commercial model and auditing was provided through a special form of government supervision separated from the usual public audit arrangements.

Government control extended to approval of general rate revisions, fundamental technical alterations, including new lines and abandonments, and the general timetable structure. Railway officials remained

a part of the civil service but they were given a special status, including the right to receive bonuses for unusual efficiency. Until 1934 the interests of the several states were recognized both through apportionment of administrative council members on a geographical basis and through an elaborate system of advisory councils. Disagreements between the corporation and the government were resolved through a special railway court appointed by the Reich President as part of the system of administrative tribunals. Its membership comprised a number of permanent judges, together with special assessors for particular cases. In addition to formal machinery regulating government relations to the corporation, control of membership on the administrative council naturally gave the government a considerable degree of influence on general policy. This was demonstrated in the late twenties by heavy railway expenditures on supplies in an effort to contribute to the reduction of unemployment.

The financial obligation for reparations payments under the Dawes Plan was implemented through the issuance of special reparations mortgage bonds carrying annual charges of 660,000,000 marks, and allocations from a transport tax on the system amounting to 290,000,000 marks per year. The bondholders were represented not only on the administrative council, but also by a foreign Railway Commissioner, who was given access to corporation records and in case of default was to become, for all practical purposes, a receiver for the entire undertaking. This office was abolished under the Young Plan and the mortgage bonds were replaced by a simple annual obligation of 660,000,000 marks on account of reparations. With the abandonment of the entire reparations scheme at the Lausanne Conference in 1932, this provision also came to an end.

Reorganization of the administrative structure under the National Socialist regime has not wholly destroyed the principle of railway autonomy, but has tended toward a reintegration of the system into the general governmental structure. The administrative council was replaced in 1937 by an advisory body; and the Director General placed in the cabinet as Minister of Transport. In rate policy, both passenger and freight, considerations of economic self-sufficiency have been superseded by wider national aims. Special rates were imposed for *Kraft durch Freude* tours, for members of the swollen bureaucracies, both party and state, for the armed forces, and for shipments of materials to be used on public works. Diversion of heavy industries into the needs of the gigantic rearmament program resulted in serious

undermaintenance of railway lines and equipment. As the entire German system became virtually transformed, years before the opening of actual hostilities, into a war economy, normal economic considerations were pushed increasingly into the background and the administrative organization ceased to be significant as a pattern for peacetime operations.

It is difficult to appraise the record of the German Railway Corporation as a whole in view of the marked instability characterizing Germany's economic structure during most of its existence. In the brief period of relative stability between 1926 and 1929 its financial results were satisfactory. At the time, association with reparations and foreign influence stigmatized the corporation in the mind of the German public. As a whole, the machinery appears to have been well devised to combine commercial flexibility and administrative devolution with adequate governmental supervision.

THE UNITED INDUSTRIES CORPORATION (VEREINIGTE INDUSTRIE-UNTERNEHMUNGEN AKTIENGESELLSCHAFT OR VIAG)

The United Industries Corporation warrants special consideration as an application of the holding company device to public enterprise. It was created in 1923 during the period of most intense financial dislocation. Unlike the railway corporation, it did not replace a previous departmental administration. The enterprises which came under its control were already private corporations in form, but their common stock was held by the Reich in amounts varying from 2 to 100 per cent. A few were mixed private and public corporations rather than public enterprises in the proper sense. For the most part, however, the remaining stock in companies only partially owned by the *Viag* was held by other public bodies, state or municipal. The objectives of this giant public holding company were co-ordination of related public enterprises, systematization of the channels of public influence upon their long-term policies, and reduction of administrative costs through consolidation of like operations. The original capitalization was equivalent to 120,000,000 gold marks, but extensions of its field of activity brought this figure up to 180,000,000 RM by 1931. The outstanding capital of its subsidiaries was over 670,000,000 RM.

In organizational form, the *Viag* follows precisely the large-scale German private corporate model. Operations are controlled by an executive council of two technicians; policy supervision is provided through an *Aufsichtsrat,* or supervisory council. The whole of the

common stock is held in the name of the state by the Minister of Finance, who consequently appoints members of the supervisory council. They have been drawn from related government agencies and from the directorates of the operating units. During the Republican regime, continuity of membership was a generally accepted principle, regardless of the party composition of the cabinet. Financial operations were conducted along private lines and administrative personnel was freed from civil service requirements.

Holdings of the *Viag* in 1938 covered a wide area, centering around public utilities, other basic heavy industries, and industries of special military significance. Some of the larger subsidiaries were themselves holding as well as operating companies, serving as administrative leaders for their particular industrial branches. At the head of the *Viag* interests stood electric power, which absorbed three fifths of its capital. Power was followed, in turn, by banking, where the *Viag* controlled the *Reichs-Kredit-Gesellschaft,* one of the German "big five" branch bank systems. Four fifths of the nation's aluminum production, important sectors of the artificial nitrates, iron and steel, and nonferrous metals industries, and miscellaneous holdings in shipping and other activities completed the list. Until the rearmament drive of 1935, economic criteria dominated the *Viag's* operations, although they were co-ordinated as far as possible with broader considerations of public policy. Dividends of 5 to 8 per cent have been paid regularly on its stock, the electrical holdings being primarily responsible for its favorable financial results. It is a striking venture in state capitalism, presenting in sharp focus the flexibility of administrative arrangements made possible by the public corporation.

THE BRITISH BROADCASTING CORPORATION

Post-World War I British public enterprises, notably the Central Electricity Board and the London Passenger Transport Board, are remarkable for the lengths to which they carry the principle of autonomy. Except for the appointment of their directing boards and the requirement of Parliamentary or administrative approval for certain major policy decisions, they are completely free operating units, selecting their own personnel, financially self-contained, obtaining capital exclusively on their own credit, and subjected to ordinary taxes. The British Broadcasting Corporation occupies a position between this extreme freedom and the ordinary government agency. Noneconomic considerations—the impact of radio on public opinion

and the democratic process, the potential abuses of broadcasting, the danger of partisan control—demand in this industry a peculiarly delicate equilibrium between free responsibility and public limitation. The British attempt to find such an equilibrium is of especial interest as the outstanding instance of a public radio monopoly within a democratic political framework.

When broadcasting became a technical possibility shortly after the first World War, the British Post Office had legal authority to control the establishment of radio stations, under an old statute designed to protect the armed forces' interest in wireless telegraphy. Pressure for creation of a regular service came in the first instance from manufacturers of receiving sets. The United States was then suffering acutely from the growing problem of congestion and interference in the ether, and the authorities were anxious to avoid a duplication of this situation. In 1922, an arrangement was made with the entire group of radio manufacturers for establishment under their control of a single British Broadcasting Company. It was financed in part from royalties on sales of sets and in part from a 50 per cent share in the annual 10 shilling receiving license fee required of listeners. This arrangement for a private broadcasting monopoly was temporary in intention. While it sufficed to provide a general service in the uncertain early years of the industry, it was thought inadequate to safeguard the long-run demands of the public interest. The manufacturers, in fact, exercised little influence over operating policy, which was determined by the managing director, Sir John Reith, a man of unusual perspective and personality. Manufacturers' interests conflicted directly with those of listeners only in a few minor respects. But they were under positive compulsion merely to provide a service adequate to stimulate sales of sets, not to improve or extend the service for its own sake. In 1926, therefore, the Company's record was reviewed by an investigating committee, and it was decided to replace it by a purely public monopoly for an experimental period of ten years.

In accordance with this recommendation, the British Broadcasting Corporation, established by Royal Charter, began operations at the beginning of 1927. Its directing body was a board of five governors, later increased to seven, appointed by the Prime Minister and Postmaster General acting in the name of the Crown. The term is for five years and is, in practice, not renewed. Adherents of all three major parties have always had a place on the board, although Con-

servatives have been more numerous than others. The membership has also always included a woman. Members are not chosen to represent special interest groups, but a certain variety of outlook has been promoted. None of the board members serves full time. The governors supervise general administration, both financial and otherwise, and determine broad questions of policy. Day-to-day operation is in charge of a full-time Director General, appointed by the Board and endowed with full responsibility.

BBC revenue is now derived almost exclusively from the 10 shilling receivers' license fee, a small proportion of which is retained by the Post Office to repay administrative expenses in connection with license issuance and enforcement.[6] The amount of income depends directly upon the number of licenses issued in a given year; it consequently cannot serve as a means of control by the Post Office over Corporation policy. From 1927 to 1939, licenses rose from 2,400,000 to 9,000,000, providing a steady increase in Corporation income. Capital expenditures are financed wholly out of revenue, since the high rate of obsolescence in radio equipment is thought to make borrowing for this purpose unwise.

The constitutional independence of the Corporation from state control is very far reaching. A number of restrictions are imposed both by the Royal Charter and by the Post Office license under which the Corporation operates. It is forbidden to broadcast advertisements or sponsored programs, or to receive any money on account of broadcast matter. Technical construction features of its stations are subject to Post Office approval and are necessarily kept within the bounds fixed by other demands upon the ether, including those of the navy, army, air force, and transatlantic radio telephones.

With regard to programs, there are three important restrictions: (1) the Corporation must broadcast for both home and empire reception during such hours as the Postmaster General may prescribe; (2) the Corporation must broadcast announcements on request by any government department; (3) "The Postmaster General may, from time to time, by notice in writing to the Corporation, require the Corporation to refrain from sending any broadcast matter (either particular or general) specified in such notice." In practice, until the outbreak of the second World War, these control measures remained

[6] The Post Office share is, in fact, considerably greater than its costs; this surplus, together with an income tax on the Corporation's net revenue, is viewed as a legitimate contribution by the industry to the state.

wholly unused, except for a general ban on all controversial broadcasting which was withdrawn early in 1928. The BBC has, in fact, not been subject to government censorship in peacetime. Like the British press, it occasionally refrains voluntarily, upon informal government request, from making public certain news items considered detrimental to the general interest.[7] Since privately owned newspapers accept the same degree of "self-restraint," this practice reflects no special government control over the broadcasting system. On one occasion when members of Parliament specifically asked the Postmaster General to use his veto power to forbid a group of talks on India, he replied, "I must trust the discretion of the Governors in this matter, who have the responsibility." [8]

The Postmaster General is considered broadly responsible to Parliament for the Corporation's operations. He must see that it keeps within the terms of its Charter and license, and speaks for it during Parliamentary debates. His representatives also audit its accounts. His powers are designed rather to prevent corruption than to influence policy. As Parliamentary spokesman for the Corporation, he serves merely as a mouthpiece for such information as the Board of Governors may choose to supply.

With the withdrawal of restraints on controversial programs in 1928, the Corporation was given the difficult responsibility of operating in this field without incurring charges of favoritism. Needless to say, it has not wholly escaped such charges; they have come at one time or another from almost every social or political group. The effect, on the whole, is to reduce the total quantity of controversial broadcasting, as compared with American practice, and to emphasize the round-table or planned series of talks in which all leading viewpoints are presented. Political broadcasts are rare, in part because of the com-

[7] Outstanding instances were the disposition of the naval forces in the Mediterranean at the opening of the Italo-Ethiopian war in 1935, and the early stages of the controversy over the marriage of Edward VIII to Mrs. Simpson in 1936.

[8] 276 H.C. Deb. 5s. 6–7 (March 20, 1933). With the opening of hostilities in 1939 general censorship of both press and radio was immediately put in force under the direction of a new Ministry of Information. The nominal independence of the BBC was not abandoned, but it adapted its programs to wartime conditions. For some years before the war it had made use of its short-wave Empire broadcasting facilities for special foreign language broadcasts designed to counteract similar programs by the totalitarian nations in various parts of the world. Relations between the Corporation and the Ministry of Information were marked by a degree of tension which led at the end of 1940 to a proposal that the radio system be incorporated into the Ministry for the duration of the war.

paratively small number of elected officials. In the general election of 1935, twelve political talks were broadcast, five going to the government (Conservative), four to the official (Labour) opposition, and three to the Liberal opposition. The small extremist parties, both Fascist and Communist, as well as the Independent Labour Party, which stands slightly to the left of the Labour Party, have thus far not been granted radio facilities. A special broadcast on the budget by the Chancellor of the Exchequer, answered by an opposition leader, is made each year. Outstanding political issues are also discussed from time to time in series of talks.

The general standards of British programs are naturally subject to every variety of criticism of detail, depending upon the particular critic's tastes and special interests. It has been suggested that a degree of quality competition might be provided by separating the present regional offices into autonomous corporations. Considerable program planning has already been devolved upon the regions, however, and centralization of ultimate responsibility assures continuous program diversity and balance. One notable advantage of the public broadcasting monopoly lies in its promotion of adequate geographical coverage. Since revenue does not depend upon advertising, the Corporation is free to give special attention to the needs of rural listeners who are most lacking in alternative media of recreation and information.

Opportunity for appraisal of the Corporation's record was provided by limitation of the original Charter period to ten years. A special investigatory committee was appointed for this purpose in 1935. After lengthy hearings, it expressed its general approval of the Corporation's policies and recommended Charter renewal for a further ten years with only minor modifications. Three days of Parliamentary debate demonstrated almost universal agreement with this attitude. While internal organization, personnel policy, and details of programs are without doubt susceptible of continuing improvement, the British public appears, on the whole, well satisfied with the BBC as a solution to the difficult problem of democratic broadcasting organization.

THE CENTRAL ELECTRICITY BOARD

The Central Electricity Board strikingly exemplifies autonomous public enterprise successfully performing a function which private enterprise had previously refused to undertake. It was created almost

with reluctance by a Conservative government in 1926 in order to construct and operate a nation-wide "grid" of high-tension transmission lines connecting the larger generating stations of the country. It has been wholly successful from the purely economic viewpoint. At the same time, it has made possible substantial improvement in generating efficiency and greatly extended power utilization for all classes of consumers.

During the first four decades after the development of the electrical industry in the early eighteen-eighties, British organization in this field was relatively backward. Electrical consumption was consequently lower than that of any comparable industrial country. These deficiencies seriously hampered the war effort in 1914–18. Generating stations were, on the whole, far too small for efficient production, while supply areas bore little relation to considerations of over-all economy. A series of official investigations at the close of the war made it clear that major improvements must be sought through high-tension interconnection and concentration of base load upon larger and more efficient stations.

A bill to implement these findings through a series of District Electricity Boards, endowed with compulsory power to acquire generating stations and main transmission lines and carrying out their program under the general guidance of a body of Electricity Commissioners, was introduced into the House of Commons in 1919. Through the opposition of vested interests in the House of Lords, it was watered down by the elimination of all compulsory authority. The utility industry failed to avail itself effectively of opportunities afforded by this Act for voluntary area co-ordination. By 1924, the Commissioners were forced to conclude "that a real reorganization, which will adequately serve the requirements of this country, can only be achieved on the voluntary basis of the Act of 1919 by a radical change in the attitude of authorized undertakers in general and that, failing the early disappearance of the obstacles which have hitherto retarded progress, the whole position will call for review." [9] Compulsion was apparently essential.

By 1926, it appeared desirable to obtain co-ordination upon a national rather than a regional scale. While local distribution was by no means in a satisfactory state, the more serious defects lay on the side of generation and long-distance transmission. The new Board, therefore, was limited to this sector of the industry. Moreover, both

[9] Electricity Commissioners, *Fourth Annual Report,* 1923–24, par. 49.

the natural bias of the Conservative Party and the serious difficulties of transferral which would have been involved led the government to avoid public ownership of the generating stations. The Board was superimposed upon the existing system, constructing and operating the transmission grid and closely controlling operations of the interlinked generating stations. The latter remained nominally in the hands of their previous owners, private or municipal.

Under the terms of the Electricity (Supply) Act, 1926, the Central Electricity Board, a body corporate, is composed of eight members appointed by the Minister of Transport for five- to ten-year terms. Members do not represent special interests as such, but the Minister is directed by the statute to obtain advice on appointments from local authorities and from trade associations and labor unions in electricity, commerce, industry, transportation, and agriculture. Board members have, in fact, been drawn from the electrical industry in both its municipal and private branches, and from banking, transportation, heavy industry, and labor. A full-time chairman also serves as chief executive, receiving an annual salary of £7,000. Parliamentary control of the Board's operations is very slight. The Minister of Transport retains a moderate degree of administrative supervision. Wider control powers rest with the Electricity Commissioners, a general, quasi-judicial, supervisory board for the industry as a whole, somewhat similar in composition and functions to our Federal Power Commission. The various "grid schemes," selecting the generating stations to be co-ordinated and designating the location of proposed transmission lines, were prepared by the Commissioners in the first instance, but required the approval of the Board before adoption. The Commissioners must also approve the Board's rate schedules and they regulate, in part, the relations between the Board and station owners. On the whole, the Commissioners combine the functions of technical advisers and general supervisors for the Board. In its actual operations, however, the latter is an independent enterprise with a broad area of discretion and responsibility.

Construction of the lines and associated transforming and switching works, which constituted the grid system, covered a period of eight years up to 1935. Normal operation began in two regions at the beginning of 1933. The investment of over £50,000,000 was financed entirely out of twenty-five to sixty-year bonds bearing fixed interest varying from 3¼ to 5 per cent. Small grants were made by the government, under a general program for stimulating employ-

ment, toward standardization of frequency in northeastern England. Previous development in that section had unfortunately been at 40 cycles rather than the 50 cycles common to the bulk of the country. This government contribution corresponded to similar assistance given to numerous private enterprises and local authorities; it did not detract from the financial autonomy of the Board.

With the grid completed, the Board's major operating function became the close control of generation on an hour-to-hour basis. All energy generated by selected stations must be sold to the Board at cost plus a reasonable profit. It is then resold by the Board to local distributors, at a rate sufficient to cover the cost of purchased energy and the Board's operating and capital expenses. The Board is a nonprofit-making organization, surplus revenues going into a reserve fund and ultimately into reduction of the spread between its purchasing and selling price for energy. It drew up its original operating budget on a ten-year basis, on the legitimate expectation of large increases in electric demand. Experience has vindicated this policy, the income in the second half of the period proving more than sufficient to pay all operating and capital costs and to liquidate the early deficits.

Economies are provided by the grid system through the concentration of base load upon the most efficient stations, reserving others for generation only at peak periods. Through the Board's seven central control rooms, continuous contact is maintained with all stations. Directions are given by Board engineers for bringing in or taking out particular capacity, as fluctuations in demand require. Interconnection also permits a substantial reduction in normal reserve requirements, by increasing the safety of the system as a whole. The Board has directly encouraged expanded consumption of electrical energy in industry, agriculture, railway electrification, and domestic use. In the decade following its establishment, annual British production rose from 159 to 454 kilowatt hours per capita, an increase of 185 per cent. Operating economies, in combination with savings in capital expenditure on reserves and new generating construction, have resulted in a total saving to the industry sufficient to pay off the entire cost of the grid in less than twenty years. While a large part of these savings was reflected in lower rates to consumers rather than in Central Electricity Board accounts, the economic position of the Board before the outbreak of the war was eminently satisfactory.

Major weaknesses in the grid plan result from inadequacies in the Board's powers and its necessarily delicate relations with station owners. Since stations were not taken over outright by the Board, exceedingly complex arrangements were required to guarantee each and every owner against possible financial loss on account of grid operations. The enterprise could have operated far more smoothly with unified ownership of the generating system, even at the cost of relatively high compensation for the displacement of previous owners. Its success despite these obstacles is a tribute to the Board's initiative and enterprise. It has demonstrated the possibility of recruiting unusual entrepreneurial ability into the public service.

2. The Public Corporation in the United States: The Tennessee Valley Authority

American public corporations fall into two broad types. Enterprises of a permanent nature are operated by the Panama Railroad Company, the Inland Waterways Corporation, and the Tennessee Valley Authority. Similar to this group is the United States Housing Authority, which promotes the construction of slum clearance projects by local authorities and subsidizes rentals for very low income groups. The second type is devoted, for the most part, to credit operations, either lending funds at low interest rates or providing insurance. It may be subdivided into three groups concerned, respectively, with general banking and industry, housing, and agriculture.[10] From this list of recently established governmental institutions, the Tennessee Valley Authority, the Reconstruction Finance Corporation, and the group of housing agencies stand out as among the most significant developments in American public enterprise. Their organization and operations therefore warrant consideration in some detail.

Although the functions of these agencies might appear in most cases to provide a prima facie case for utilization of public corporations, Congress, in fact, gave little consideration to questions of administrative organization when they were set up. In the first two years of the Roosevelt Administration, a veritable spate of government corporations flowed out of emergency needs, without adequate attention to details of form, maintenance of lines of authority, fi-

[10] The major agricultural credit agencies, grouped under the Farm Credit Administration, are briefly treated above, on pp. 125 to 129.

nancial accountability, or means of co-ordination. The corporation appeared the simplest solution to immediate short-term necessities.

In some cases, particularly in the agricultural group, these agencies were in reality engaged in spending rather than lending; their operations were more akin to the broader welfare activities of the Agriculture Department than to commercial public enterprise. The early New Deal public corporations were often endowed with excessive freedom from ordinary governmental controls. In recent years, their autonomy has been significantly curbed in several respects. The practice of chartering federal corporations in Delaware, where the laxness of incorporation laws has often been a matter of unfavorable government comment, has been abandoned. Either by executive order or by special provision in appropriation acts, regular accounting to the Treasury, budgetary control over administrative expenses, and audit through the General Accounting Office have been restored with few exceptions.

Administrative integration has been provided by regrouping the bulk of these agencies under various reorganization plans. The corporate form has been retained in most instances, but is subjected to general supervision by an appropriate co-ordinating authority. Credit agencies in the banking, industrial, and housing fields have been placed under the Federal Loan Agency; agricultural credit corporations under the Department of Agriculture; the United States Housing Authority under the Federal Works Agency; and the Inland Waterways Corporation under the Department of Commerce. The Panama Railroad Company is associated with the general government of the Canal Zone. Only the Federal Deposit Insurance Corporation and the Tennessee Valley Authority remain wholly apart from the general executive establishment.

THE TENNESSEE VALLEY AUTHORITY

The Tennessee Valley Authority was established in 1933 in order to develop and control the waters of the Tennessee River and its tributaries for the combined purposes of hydroelectric power, navigation, flood control, and recreation. It was also designed to develop the local production of fertilizer, to improve land use in the Tennessee Basin through soil erosion control, reforestation, and allied operations, and to promote the national defense through the manufacture of artificial nitrates and otherwise.

Federal interest in the Tennessee goes back to the early nine-

teenth century, when its improvement for navigation was first considered. With the increase of the Valley's population in the period after the Civil War, the needs of flood control came into prominence. At the beginning of the twentieth century, the wave of general interest in conservation of natural resources, stimulated by the leadership of Theodore Roosevelt, led to serious consideration of multiple-purpose development of the river for navigation, flood control, and power objectives. Important large-scale operations, however, were undertaken only in pursuance of defense requirements during our participation in the first World War. Under the National Defense Act of 1916, Wilson Dam was constructed at Muscle Shoals to generate power for manufacturing explosives. Associated properties included two nitrogen fixation plants, a stand-by steam-power plant, a quarry, and three villages. Hostilities were terminated before the explosive plants were fully equipped, and the dam was not completed until 1925.

President Wilson's Administration desired to retain the Muscle Shoals project, operating it under a government corporation for power generation and fertilizer manufacture, with provision for reconversion to explosives in the event of another emergency. This proposal was rejected by the Republican majority on the House Military Affairs Committee. With the change of administration in 1921, public operation as a permanent policy seemed doomed. Efforts were made to dispose of the plants to private purchasers. An offer by Henry Ford was incorporated in a bill which passed the House of Representatives, but it and other similar proposals were successfully opposed in the Senate. There Senator Norris of Nebraska, the Chairman of the Agriculture and Forestry Committee, conducted a one-man campaign for a dozen years to obtain government operation. He was supported by a powerful agrarian bloc interested primarily in the possibilities of public fertilizer production as a check on prices in the allegedly monopolistic private industry. In 1928, and again in 1931, Senator Norris succeeded in pressing his proposal through both Houses of Congress, only to be balked by Presidential veto. In the face of this political deadlock, the federal investment lay almost idle.

The impasse was broken with the election of President Roosevelt in 1932. He was in sympathy not only with the interests of the agrarian Senators, but also with public power production as a "yardstick" for private utilities and with the co-ordinated planning of

water and land use as a whole. His message of April 10, 1933, recommended creation for these purposes of "a corporation clothed with the power of Government, but possessed of the flexibility and initiative of a private enterprise . . . charged with the broadest duty of planning for the proper use, conservation and development of the natural resources of the Tennessee River drainage basin and its adjoining territory for the general social and economic welfare of the Nation." The Tennessee Valley Authority Act was signed six weeks later. The only significant amendments were made in 1935, substantially enlarging the TVA's powers and strengthening its position, and, in 1939, authorizing bond issues for the acquisition of private utility properties.

The Act established the TVA as a body corporate under the direction of a three-man Board appointed by the President with Senatorial confirmation. It enjoys a degree of independence more substantial than that of an ordinary government department, but far less than that of corresponding agencies in Great Britain. The form of organization was defended by the Congressional Conference Committee in 1933 in the following terms:

> We are fully persuaded that the full success of the Tennessee Valley development project will depend more upon the ability, vision, and executive capacity of the members of the Board than upon legislative provisions. We have sought to set up a legislative framework, but not to encase it in a legislative strait jacket. We intend that the corporation shall have much of the essential freedom and elasticity of a private business corporation. We have indicated the course it shall take but have not directed the particular steps it shall make. We have given it ample power and tried to prevent the perversion and abuse of that power. We have set bounds to prevent its liberty from becoming license.[11]

[11] *Conference Report on Operation of Muscle Shoals Properties,* May 15, 1933, H. Rept. 130, 73rd Cong., 1st Sess.

When President O'Neal of the American Farm Bureau Federation asked that a definite obligation to produce fertilizer in commercial quantities be placed on the Authority, Congressman McSwain, Chairman of the House Military Affairs Committee, replied:

"The authority is given and I left it to the Board, who will act as common-sense businessmen, we hope, and who will be picked by the President, no doubt, with great care, and the Senate will no doubt scrutinize their attitudes of mind, economic reactions, and so forth, before the Senate confirms them. Then they can, like directors of a private enterprise, do whatever is best for the country and the government. If we were to fix an absolute minimum, an unconditional minimum, and it should ultimately develop that the production of that absolute minimum was at a loss to the

Members of the Board are appointed for nine-year staggered terms, receive salaries of $10,000 a year, and must devote their full time to the TVA. The statute requires that they "profess a belief in the feasibility and wisdom of this Act." They may be removed from office at any time without stated cause by a concurrent resolution of both Houses of Congress. Although Presidential removal is nowhere specifically provided, accepted constitutional doctrine appears to give the President such power automatically for all agencies performing purely executive functions. The first Chairman, Dr. Arthur E. Morgan, was, in fact, removed by the President for stated reasons in March, 1938.[12] Despite his power to remove members without stated cause, the provision for a definite term imposes upon the President a moral obligation not to make use of it for purely political purposes.

The TVA combines commercial functions in the production of power, and in part of fertilizer, with noncommercial functions in improving navigation and in general planning and development of the Valley. Unless its great variety of operations were all to be financed out of power revenues (with possible additions from fertilizer sales and navigation tolls), the Authority could not in its nature be financially self-supporting. Because of its noncommercial functions, it necessarily depends in part upon Congressional appropriations for its continued existence. This factor conditions the entire status of the TVA as a public corporation and imposes upon it important Congressional restraints.

So far as internal organization is concerned, the Authority has been granted a remarkable degree of freedom. Its salaried personnel numbers about twenty-five hundred; employment of construction

government, that it was not profitable, that the stuff did not sell, then there would be nothing left for us except to dump it into the Tennessee River . . . ; so as not to keep on doing it they would have to come to Congress to release them from that mandate." House Military Affairs Committee, 73rd Cong., 1st Sess., *Hearings on Muscle Shoals,* April, 1933, pp. 86–87.

[12] The reasons were stated by the President as follows:

"(a) Openly making grave and libelous charges of dishonesty and want of integrity against your fellow directors without reasonable excuse or justification. (b) Obstructing the work of the Tennessee Valley Authority. (c) Refusing to submit to the demand of the Chief Executive for the facts upon which you relied in openly making grave and libelous charges of dishonesty and want of integrity against your fellow directors, and refusing to respond to questions of the Chief Executive relating to charges of obstruction made against you by your fellow directors."

S. Doc. 155, 75th Cong., 3rd Sess., 1938, p. xii.

workers on a nonpermanent basis increases that number at times by as many as nine thousand. The TVA is exempted from civil service requirements, but the Act forbids consideration of political tests in appointments or promotions and requires that they be made solely on the basis of merit and efficiency. The first injunction appears to have been carried out to the letter, despite heavy pressure from members of Congress seeking positions for constituents.[13] A strict rule against nepotism, forbidding more than one member of a family to obtain salaried positions, is in sharp contrast with practice in private industry. The general economic situation when the TVA began operations made available an unusual field of professional and administrative ability and induced a flood of applications for employment. The Authority has developed its own merit system, based on examination of qualifications, recommendations, and personal interview.

A leading expert in personnel administration, Dr. Leonard D. White, examined the TVA's personnel policy on behalf of the Congressional Investigating Committee of 1939. He concluded:

> At certain points the policy . . . now requires reconsideration in view of the passing of the period of rapid organization. At certain other points the personnel policy of the Authority has introduced significant improvements in established practice which other progressive jurisdictions may apply to their advantage.[14]

In his opinion, the Authority would benefit in the future, now that its basic staff had been assembled, from application of the general civil service system. The majority of the Committee dissented from this recommendation. They stressed the continued need of "imagination and initiative as in private enterprise," and the remarkable *esprit de corps* and staff enthusiasm for the Authority's welfare which had been remarked almost unanimously by observers of its operations.

TVA construction has been carried on under direct supervision (so-called "force account") rather than by contract. Laborers were selected from applicants living in the region by an examination following the model developed by the Civil Service Commission for

[13] See *Report of the Joint Committee on the Investigation of the Tennessee Valley Authority,* S. Doc. 56, 76th Cong., 1st Sess., 1939, Appendix A, Part 2, p. 66.

[14] *Ibid.*

workers in the navy yards. The turnover has been very low and labor relations have been excellent.

In its early years the TVA's highly satisfactory personnel policy was not paralleled by equal wisdom in internal organization. Instead of concentrating executive functions either in a general manager immediately under the Board, or in a single member of the Board as managing director, the Authority divided operations into three broad fields, with a director assigned to each for executive supervision. Chairman Arthur E. Morgan took charge of dam construction and navigation; Director Harcourt A. Morgan supervised fertilizer production and soil conservation activities; and Director David E. Lilienthal guided the Authority's power program. While the Board nominally acted as a corporate body for determining general policy, the directors inevitably became primarily interested in their separate sections and acted as their partisans in cases of conflicting interests. Although the severe frictions among the directors —which by 1937 became so intense that the other Board members were no longer able to work as an effective unit with Chairman A. E. Morgan—were engendered primarily by clashes of personality and profound divergence in fundamental attitudes toward the Authority's operations, they were intensified by this division of executive responsibility. The error was remedied in 1937 by appointment of a general manager and the internal lines of organization have subsequently been greatly improved.

The contrast of the TVA's position with the far-reaching autonomy enjoyed by European public corporations appears most strikingly in its financial arrangements. Not only are funds for noncommercial operations supplied by annual Congressional appropriation; this method has also been used in preference to the issuance of TVA bonds for the bulk of the Authority's capital investment. Of the total ultimate investment amounting to some $535,000,000, only about $70,000,000 will be provided through bond issues, most of this amount for the purpose of purchasing private utility properties.

Power revenues flow directly into the United States Treasury each year, after deduction of sums required to operate and maintain the dams and reservoirs, power facilities, and fertilizer program, and to provide an emergency reserve fund of $1,000,000. Since the first seven years have been devoted chiefly to construction, and the sales of power were delayed until 1939 by litigation, annual expenditures

have thus far greatly exceeded income. When construction is completed, power revenues are expected by the Authority to be sufficient to repay to the Treasury the capital cost, without interest, of the entire dam and reservoir system, together with interest on that portion, including separable power facilities, allocated to the power program. The mixed functions of the TVA will always necessitate annual appropriations for miscellaneous operations.

The practice of financing its construction program almost entirely by Congressional appropriation has forced the TVA to fight a continuous political battle for the integrity of its plan of development. In three successive years, opposition in the House of Representatives threatened serious dislocation through failure to appropriate funds for Kentucky Dam, the furthest downstream in the proposed development, which is to play a vital role in both the navigation and flood control features of the program. Private utility interests and coal producers, who fear the effects of water-power development on their markets, have composed the core of the opposition; it has also included a majority of Congressional Republicans on general grounds of policy. Only with the aid of a favorable Administration, reinforced by the support of direct local beneficiaries, agricultural interests concerned with the fertilizer program, and advocates of more effective public utility control, has the Authority successfully weathered the opposition during its crucial initial period. Acquisition of Commonwealth and Southern properties in the summer of 1939 marked its final emergence into a stable position, with reasonable certainty of permanent continuance. Many of the disadvantages derived from the TVA's treatment as a political football might have been avoided, once the policy of developing the Tennessee through public enterprise was definitely adopted in 1933, by financing the entire capital expenditure out of guaranteed revenue bonds. Budgetary and Congressional checks would then have been limited to administrative expenditures and contributions to the noncommercial elements of the Authority's operations.

The TVA has borne the brunt of the struggle between the General Accounting Office and recently created public corporations over the extent to which ordinary government controls over expenditures should be maintained. The Authority has contended that the nature of its work and the intent of its form of organization demand flexibility and discretion for the most efficient performance of its duties. The Comptroller General has always insisted that, both

in law and as a matter of policy, checks and controls applicable to ordinary agencies should be extended *in toto* to the TVA. The conflict came to a head in the very first year of the Authority's operations. The Comptroller General released a four-hundred-page report, detailing $2,000,000 of exceptions to TVA expenditures and severely criticizing departures from general government practice. Interests unfriendly to the Authority gave the report wide circulation and it evoked a great deal of unfavorable publicity. The TVA had had no opportunity to examine the document before its release. Upon further investigation, all but $81,000 of the exceptions were recommended for release by the General Accounting Office field auditors. The bulk of the items had to do with methods of purchase of private properties; awarding of construction contracts to other than the lowest bidders where higher qualities of materials, improved design, and greater financial responsibility had seemed to warrant this procedure; and minor exceptions based upon differences in interpretation of the TVA's statutory authority. In the words of the Congressional Investigating Committee: "The objections made illustrate clearly the difference between the freedom of action of a corporation and the strait jacket of red tape which the General Accounting Office sought to impose on the Authority." [15]

In order to obtain outside advice on its operations, the Authority employs of its own accord a leading firm of private chartered accountants. This commercial audit emphasizes operating efficiency and accounting reliability, rather than concerning itself exclusively with legality in the manner of the General Accounting Office. Repetition of the 1934 incident has been made impossible by an amendment to the Act, providing that no report on TVA operations be made by the Comptroller General until the Authority has had reasonable opportunity to examine its contents and to point out, explain, and answer errors therein. In the opinion of the Investigating Committee, the General Accounting Office audit should be entirely abandoned in favor of a commercial audit made annually by a firm to be selected by a special joint committee of Congress.

TVA operations to date have been concerned predominantly with construction of the ten major dams and allied works constituting the basic engineering structures of the river control program. Of the total expected investment of $535,000,000, some $350,000,000 had been expended by the end of 1940. Seven of the dams were virtually

[15] S. Doc. 56, 76th Cong., 1st Sess., p. 125.

completed, two were in an advanced stage, and one barely begun. Unforeseen national defense needs have added to the immediate construction program a power and flood control dam on the Holston River, originally scheduled for an indeterminate period in the future, and additional steam capacity and transmission lines.

With completion of Kentucky and Hales Bar Dams in 1945, the nine-foot navigation channel required by the Act from Knoxville to the river's junction with the Ohio will be provided over 605 out of the total of 652 miles. Kentucky Dam is one of the most important elements in the flood control program, since the extremely gradual rise in the Valley behind it will produce an enormous reservoir and correspondingly large capacity per foot of dam height. In addition to protection within the Valley itself, particularly at Chattanooga, the system as a whole will substantially reduce flood crests at Cairo, Illinois, and on the lower Mississippi. During dry periods, moreover, as in the summer of 1939, controlled release of stored water in the Tennessee system may be of value to lower Mississippi navigation.

Of the ultimate total hydroelectric capacity of almost 1,900,000 kilowatts, over 900,000 kilowatts have already been installed. Power features of the TVA program, including the use of the "yardstick" as a regulatory device, have been treated in Chapter 10 and require no further discussion. It is of importance, however, to note that the Tennessee offers peculiarly favorable opportunities for efficient multiple-purpose water control, jointly pursuing the objectives of flood control, navigation, and power. Floods occur in the area only between December and April. The reservoirs may, therefore, be filled gradually in the spring and drawn down during the low-flow summer and autumn periods to supply both power and navigation requirements. Integration with steam stations also permits the use of stored water for power-peaking purposes and may be used to convert large blocks of secondary power (not available continuously) into firm (continuous) power. Advantages of multiple-purpose development, combining commercial with noncommercial objectives, are a major factor favoring public enterprise for this type of operation.

Agricultural activities of the TVA, which center about its fertilizer program, are second in importance only to the river development itself. Technical progress in production of nitrates, together with improved methods of restoring the soil's nitrogen content

through leguminous crops, had made the World War I plants at Muscle Shoals obsolete by the time the TVA was created. At the behest of agricultural interests, the Authority's Act of 1933 was drawn sufficiently broadly to enable the Authority to develop new production techniques for any variety of fertilizer. Under the leadership of Harcourt A. Morgan, the present Chairman, the TVA turned its attention to the development of phosphates, now the most pressing need in the maintenance of soil fertility.

Tennessee contains some of the major phosphatic rock reserves of the nation, ranking in this respect only after the enormous but relatively inaccessible fields of the Rockies and the highly developed supplies of Florida. Most commercial mixed fertilizers in the past have contained only a low percentage of active ingredients, resulting in heavy transportation charges and high prices to consuming farmers. The TVA has pursued a threefold program in this field: (a) developing new methods of production for highly concentrated phosphates, linked in part to the power program through utilization of electrothermal processes; (b) co-operating with agricultural experiment stations and land grant colleges throughout the country in demonstrating fertilization techniques; and (c) selling the product of its experimental large-scale production plants at cost to the Agricultural Adjustment Administration for distribution to farmers in lieu of cash payments. The private fertilizer industry has viewed the program with some misgivings as a source of potential competition. The Authority, however, stresses its intention to restrict total output to amounts required for effective experiment and demonstration, looking to private manufacturers to follow its lead by furnishing the new products in bulk.

Allied to the fertilizer operations are a host of miscellaneous agricultural activities designed to improve land use in the Valley. They include soil erosion prevention (which is incidentally essential to avoidance of siltation of the system reservoirs), reforestation, diversification of crops, and development of low-cost machinery for small farms. The Authority is also developing recreational facilities around the new artificial lakes and promoting malaria control and other public health services. Work of this nature is closely coordinated with the appropriate federal, state, and local agencies.

Opportunity for an exhaustive review of TVA organization and policy as a whole was afforded in 1938 as an incidental by-product of the critical disputes within the Board of Directors. A joint Con-

gressional Committee, composed of five members from each House, was established "to make a full and complete investigation of the administration of the Tennessee Valley Authority Act." The Committee heard testimony from 101 witnesses, including all the chief officers of the TVA and representatives of the public utility industry. It also employed a distinguished electrical engineer for a special investigation and obtained reports from outside experts on particular aspects of TVA operations. Although the majority of the Committee was favorably inclined toward the TVA from the outset, the investigation was very thoroughgoing and full opportunity was given for presentation of the opposition's case. The majority report,[16] which was signed by five Democrats and one Republican, thoroughly vindicated the TVA's record. Its conclusions were summarized in the following terms:

> In the committee's opinion, the Authority should be regarded as a settled and established institution in the Valley. Its construction program should be carried to completion so that the money already invested may not be wasted or inadequately supported by revenue. The agricultural, forestry, public-health, and other regional development programs of the Authority are generally acknowledged to be beneficial to the region and to the Nation as a whole, and should be continued. The Authority has already demonstrated the value of unified river control under public management. It is on the way to full demonstration of the practicability of promotional rates for domestic electric service, which may be adopted as well by private utilities as under public ownership.[17]

A minority of three, all Republicans, disagreed completely with this viewpoint. They recommended complete reorganization of the TVA, transferring agricultural activities to the Department of Agriculture and river control to the War Department. Only wholesale power supply would be retained under the Authority, which would be subjected to far closer Congressional control. To them, the TVA appeared as a "beautiful example of bureaucracy out of control." Partisan considerations deprived the report of some of its value, but on the whole the investigation redounded to the Authority's benefit.

Viewed in its entirety, the TVA is a unique experiment in planned regional development under semiautonomous public enter-

[16] Owing to death and resignations, the membership of the Committee was somewhat changed during its existence and numbered only nine at the time of its final report.

[17] S. Doc. 56, 76th Cong., 1st Sess., p. 259.

prise. The unusual devotion of its staff members to their tasks is doubtless in large measure actuated by a vivid consciousness of the pioneering character of the Authority's efforts. Consideration has inevitably been given to the possibility of imitating the experiment elsewhere in the nation. In the summer of 1937 it was proposed by the President that Congress establish six additional regional planning agencies covering respectively the Atlantic Seaboard, the Great Lakes–Ohio Valley, the Missouri Valley, the Arkansas Valley, the Southwest, and the Columbia Valley. Elaborate hearings were held on bills to implement this proposal, but sufficiently powerful resistance was generated to prevent substantial headway in Congress.

While opposition was focused upon the power implications of the proposal, this factor was supported by general antagonism to federal centralization. The attitude brings to light one of the basic defects in the TVA organization. It is a regional agency drawing its authority wholly from Washington and lacking any political foundation in direct local responsibility. The Authority has made strenuous and, for the most part, successful efforts to mitigate the atmosphere of a "federal province" by various forms of local cooperation. The potentialities of the corporate device, however, extend beyond such efforts. They make possible a new type of regionalism bringing together local responsibility for issues of direct local concern with federal responsibility for the wider national interest. In other sections of the nation, joint participation of states and localities, along with the federal government, in corporate public enterprise for natural resource development appears to have more promise than exact reproduction of the model established by the TVA.

3. Federal Credit Agencies

THE RECONSTRUCTION FINANCE CORPORATION

Measured in terms of financial operations, the Reconstruction Finance Corporation is by far the largest American public enterprise and one of the largest enterprises of any sort in the nation. It was created in 1932 on President Hoover's recommendation, as one of a series of measures designed "to check the further degeneration in prices and values, to fortify us from continued shocks from world instability and to unshackle the forces of recovery." [18]

[18] Message to Congress, January 4, 1932, 75 *Congressional Record,* 1263.

In organization and general powers it was modeled after the War Finance Corporation, which had used government credit to support the rural banking structure in the first shock of the postwar agricultural depression. Governor Eugene Meyer of the Federal Reserve Board, who had conducted the War Finance Corporation's activities, was its leading sponsor. The bill was supported by banking and financial interests throughout the country.

RFC lending powers were originally to be confined to banks, insurance companies, other financial institutions, and railroads. During passage of the original Act, industrial corporations were also added to the eligible list. Under the Emergency Relief and Construction Act of 1932, the Corporation might make loans to state and local authorities for direct relief and work relief, but these functions were later transferred to the series of special relief agencies created under the Roosevelt Administration. At its inception, the RFC was viewed as a strictly emergency agency. Lending authority was limited to a period of one year, subject to extension by the President for a further two years. A series of subsequent statutes, however, have prolonged the lending power to the middle of 1941, and it will doubtless be extended for an indefinite period beyond that date. The scope of RFC activities has been expanded by no less than eighty separate pieces of legislation. Taken as a whole, they extend its assistance to practically every sector of the American economy.

Management was originally vested in a Board of seven directors, including the Secretary of the Treasury, the Governor of the Federal Reserve Board, and the Farm Loan Commissioner, ex officio. Subsequent amendments have removed the ex officio membership; the Board is now composed of five full-time members on a bipartisan basis, drawn from different sections of the country and appointed by the President with Senatorial confirmation. The entire capital, $500,000,000, was subscribed in full by the Treasury in 1932. Additional funds are provided through the issuance of government guaranteed notes with terms up to five years, carrying interest at the rate of 1 per cent or less, and marketed to the public through the Treasury. Approximately $1,100,000,000 of such notes are now outstanding. The Corporation's loans are ordinarily made for periods of six months to five years. Repayments flow into a revolving fund and become available for further lending activities. In eight years

of operation, the aggregate disbursements of the RFC have amounted to well over $10,000,000,000.

The Corporation is fully self-supporting. Its administrative expenses, amounting to almost $10,000,000 a year and carrying a personnel of some seventeen hundred, are paid out of income from loans. A limited budgetary and Congressional check is retained, however, by the requirement that payment of administrative expenses be authorized in the annual Independent Offices Appropriation Bills. Congress also receives a monthly report listing each loan recipient together with the terms of the loan, and a quarterly report summarizing the Corporation's activities. The RFC is entirely free from audit by the General Accounting Office. It has established a continuing internal audit by a special division within the organization and also secures an annual review of its activities by a firm of private accountants.

The various additions to RFC authority since 1932 are based upon a variety of motivations. Congress has called upon its assistance whenever the existing debt structure in an important sector of the economy threatened to break down. The lending powers now apply to banks and trust companies, building and loan associations, agricultural credit institutions, railroads, parties to agricultural marketing agreements, the fishing industry, business enterprises in general, construction of public works, mining companies, public school construction and payment of teachers' salaries, reconstruction after natural catastrophes, rural electrification, aid in the export of agricultural or other products, reclamation projects, and expansion of manufacturing plant and other activities in connection with the defense program. In general, credit is extended only where repayment is reasonably assured and alternative private sources are not available.

The President may suspend the RFC's lending authority for any class of borrowers upon a finding that private credit facilities are adequate to meet their needs on reasonable terms. Toward the end of 1937, he directed the Corporation to curtail all further lending operations. As a result of the sharp recession then in progress, however, this decision was revoked in February, 1938.

RFC facilities are expected to play an important role in providing credit for expanded activities under the current defense program. The Corporation was given authority in 1940 to purchase bonds or stock in companies producing or acquiring strategic and critical

RECONSTRUCTION FINANCE CORPOR

February 2, 1932 Thr

	Authorizations
For benefit of agriculture	$2,584,639,140
To open banks to meet demands of depositors	1,334,744,454
For distribution to depositors in closed banks	1,331,814,759
For bank capital (including Export-Import Banks)	1,349,234,714
For Self-Liquidating projects (including PWA municipal securities)	954,058,325
To business enterprises	390,816,097 [a]
To drainage, levee and irrigation districts	142,845,995
To railroads (including receivers and trustees)	1,248,348,560
For loans to and capital of mortgage loan companies (including $25,000,000 capital RFC Mortgage Company and $11,000,000 capital Federal National Mortgage Association)	608,597,899
For loans to and capital of insurance companies	138,914,750
To building and loan associations (including receivers)	154,240,454
To public school authorities	24,586,800
Catastrophe rehabilitation loans	16,784,521
To state funds for insurance of deposits of public moneys	13,087,716
For mining, milling and smelting businesses	12,655,500
For other purposes	669,057
Total—By Directors of the Corporation	$10,306,038,741
Allocations and loans to other governmental agencies and for relief by direction of Congress	2,900,601,066
Grand Total	$13,206,639,807

[*] Includes $25,111,268 credited on indebtedness for property taken over for debt.
[a] Total loans to business of RFC and participating banks, $447,324,578. Bank par
[b] Includes $2,699,236,946 cancellation of Corporation's notes pursuant to Act of

[20] Reconstruction Finance Corporation, *Seven-Year Report* (1939), p. 22.

ATION—SUMMARY OF ACTIVITIES [20]

ough February 1, 1939

Cancellations	Disbursements	Repayments and Other Credits *	Balance Outstanding
$982,459,540	$1,446,284,760	$1,414,958,458	$31,326,302
196,378,317	1,138,217,337	1,060,626,324	77,591,013
327,511,981	983,701,788	920,580,062	63,121,726
169,593,552	1,146,590,662	562,558,630	584,032,032
44,719,243	741,744,404	457,826,219	283,918,185
86,027,903	160,595,495	49,697,449	110,898,046
20,480,759	85,600,433	3,204,792	82,395,641
307,561,724	826,773,161	346,509,316	480,263,845
103,599,895	418,662,964	298,016,329	120,646,635
13,331,442	125,168,210	95,374,562	29,793,648
29,028,416	118,221,783	116,255,022	1,966,761
1,267,300	22,450,000	22,301,000	149,000
4,139,466	12,003,055	9,546,494	2,456,561
23,085	13,064,631	13,064,631	
7,392,000	4,179,700	1,531,252	2,648,448
54,243	614,814	514,489	100,325
$2,293,568,866	$ 7,243,873,197	$5,372,565,029 *	$1,871,308,168
15,001	2,801,096,178	2,753,398,603 [b]	47,697,575
$2,293,583,867	$10,044,969,375	$8,125,963,632 *	$1,919,005,743

ticipations $61,492,756, including $4,984,275 RFC loans taken up by banks.
Congress approved February 24, 1938.

materials, and to finance plant construction or expansion for the manufacture of defense equipment and supplies. In addition, it was empowered to create active operating subsidiaries in the following terms:

> When requested by the Federal Loan Administrator, with the approval of the President, to create or to organize a corporation or corporations, with power (a) to produce, acquire, and carry strategic and critical materials as defined by the President, (b) to purchase and lease land, to purchase, lease, build, and expand plants, and to purchase and produce equipment, supplies, and machinery, for the manufacture of arms, ammunition, and implements of war, (c) to lease such plants to private corporations to engage in such manufacture, and (d) if the President finds that it is necessary for a Government agency to engage in such manufacture, to engage in such manufacture itself. The Corporation may make loans to, or purchase the capital stock of, any such corporation for any purpose within the powers of the corporation as above set forth or related to the national-defense program, on such terms and conditions as the Corporation may determine.[19]

These unprecedented discretionary powers are designed to serve both as a basis for public enterprise in defense industries which cannot be profitable in peacetime and also as a bargaining lever to stimulate private enterprise to more intensive effort. If widely used, they will shift the emphasis of the RFC from credit operations to large-scale industrial production, following the pattern of the German *Viag*.

The magnitude of RFC operations up to 1939 is shown in the table on pages 718–719. Financial results so far have been thoroughly satisfactory. Besides paying its administrative expenses out of income, the Corporation has accumulated a reserve of over $260,000,000. The amount of defaults has been disclosed only for certain classes of loans, including $18,000,000 in the banking field and $5,000,000 in industry. The total expected defaults, however, are said to be amply covered by the reserve.

Certain related lending activities of the federal government are carried on through public corporations affiliated with the RFC. The Disaster Loan Corporation was established in 1937 as a result of the Ohio-Mississippi floods to finance reconstruction activities up to a total of $50,000,000. Its stock is held partly by the RFC and partly

[19] Section 5, Act of June 5, 1940, Public No. 664, 76th Cong., 3rd Sess. For the first five subsidiaries so created, see above, p. 686, note 2.

by the Treasury, and its managing director is a member of the RFC Board. For financing the purchase of electrical appliances, the Electric Home and Farm Authority, Inc., a Delaware corporation created by the TVA board in 1933, was transformed in 1935 into a District of Columbia corporation under a board of trustees, all of whom are officers or employees of the RFC. It operates with a capital stock of $850,000 provided by the Treasury. Another affiliated corporation is the Export-Import Bank of Washington, created in 1934, which aids in financing foreign trade and contains on its Board several representatives of the RFC, along with members from the Departments of Commerce, State, Treasury, and Agriculture.

While statutory provisions afford a framework guiding the detailed application of RFC lending authority, it retains an enormous area of discretion in selecting among applicants for loans, in determining appropriate interest charges and other lending terms, and in taking measures to assure itself of repayment. It has acquired a substantial amount of stock in various enterprises in the course of its operations, and is consequently in a position to influence their operating policies. The confidence which the Corporation has engendered in both Congress and the country at large is a function of the cautious manner in which it has administered its duties. This record has been closely associated with the personality of Jesse H. Jones, RFC Chairman for over seven years. His unusual position was strikingly demonstrated in 1940, when special legislation was enacted enabling him to retain his position as Federal Loan Administrator, in charge of the RFC and other credit agencies, while also becoming Secretary of Commerce.

THE HOUSING GROUP

Federal interest in housing has developed only during the last decade. In this brief period, however, it has attained an intensity and breadth of scope paralleled only in the area of agricultural assistance. The immediate impetus to assumption by Congress of obligations in the housing field was the disastrous deterioration of the home financing system, approaching total collapse, during the unprecedented deflation of 1929–33. Difficulties affecting every aspect of the nation's debt structure were peculiarly aggravated by special features of the mortgage market. Real estate values were excessively inflated during the boom; the collapse was correspondingly critical. High-pressure salesmanship promoted home financing on a large

scale beyond even the prosperity income of many owners, and far beyond their depression income. Mortgage credit was generally on an unsatisfactory basis, often provided for short terms without amortization, based on vague and unscientific methods of appraisal, and ordinarily depended solely upon local sources of credit which were unable to draw upon surpluses elsewhere to support their finances in times of need. The appalling increase in foreclosure rates as the depression deepened simply worsened the situation, throwing large volumes of property on the market, further depressing values, and further threatening the remainder of the credit structure. In the summer of 1933, the rate of foreclosures on homes had reached more than one thousand a day. The cumulative effect of widespread dispossessions, added to growing loss of employment, threatened collapse in national morale. The initial proposal for federal action came from home-financing institutions, but it was supported by an enormous inarticulate demand in the entire nation.

The federal government responded to these needs by creating a series of interrelated corporate agencies designed to achieve four objectives. Long-run reform of the mortgage system, in order to provide more adequate credit facilities in normal times and prevent repetition of the depression catastrophe, was to be promoted through the Federal Home Loan Bank system, including the Federal Savings and Loan Insurance Corporation, the Federal National Mortgage Association, and the RFC Mortgage Company. Related to this objective was a salvage operation for distressed homeowners on an enormous scale, carried out through the Home Owners' Loan Corporation. The Federal Housing Administration, in the third place, sought to stimulate new private construction and modernization on a remunerative basis. The final element in the total program was subsidization, through the United States Housing Authority, of projects for slum clearance and low-cost housing which apparently could not be supported on a wholly commercial basis.

The system of Federal Home Loan banks was established in 1932 in an effort to relieve home-financing institutions and borrowers and improve the mortgage system for the future. It proved wholly inadequate as a solution to the former problem, which was aggressively attacked only after the change of Administration in 1933; it did, however, provide an important long-term reform. Modeled after the Federal Reserve System, it consists of a central Federal Home Loan Bank Board of five members, appointed by the President and Sen-

ate for six-year staggered terms, twelve Federal Home Loan banks, and numerous member institutions. The latter include all federal savings and loan associations and such state associations, insurance companies, and savings banks as wish to join. The twelve banks are financed in part by member institutions and in part by the federal government. The system provides for loans by banks to member institutions, with funds derived from consolidated debentures and bonds issued under the Board's authority for the twelve banks jointly. The obligations are not government guaranteed. The only government contribution to the system is made through the small differential between its dividends as a bank stockholder and the going federal rate of interest.

About half the building and loan associations in the country are now included in the system. It provides a reserve of credit which may be transferred to particular localities as special financing needs dictate. Associated with the Board is the Federal Savings and Loan Insurance Corporation, established in 1934 on the model of the Federal Deposit Insurance Corporation to guarantee building and loan association accounts. Funds are drawn from assessments on insured institutions. The Corporation is administered by a board of trustees identical in membership with the Federal Home Loan Bank Board. Reform of the mortgage system is rounded out by the Federal National Mortgage Association and the RFC Mortgage Company, both wholly owned by the RFC, which are designed to provide a national market for insured mortgages under the National Housing Act.

The Federal Home Loan Bank Act of 1932 attempted to stem the tide of foreclosures by authorizing the banks to make direct loans to mortgagors up to 50 per cent of the appraised value of the properties. This provision resembled a flimsy picket fence before an avalanche. Only a few thousand dollars were loaned under its terms. Salvage operations on a more effective scale were provided by an almost unanimous vote of Congress in the spring of 1933, upon the urgent recommendation of the President. "The broad interests of the nation," he said, "require that special safeguards should be thrown around home ownership as a guarantee of social and economic stability . . . to protect homeowners from inequitable and forced liquidation in a time of economic distress is a proper concern of government."

The Home Owners' Loan Corporation was created for this task.

It was directed by members of the Federal Home Loan Bank Board, and received its entire capital of $200,000,000 from the Treasury. It was authorized to issue bonds up to $2,000,000,000, with government guarantee of principal but not interest. The guarantee was later made complete and the authorization raised to $4,750,000,000. After 1934, its operations were limited to mortgagors either actually in involuntary default or reasonably certain to become so due to circumstances beyond their control. The HOLC refinanced mortgages by exchanging them with mortgagees for its bonds. It was also authorized to advance cash for payment of taxes, maintenance, and repairs. Lending operations ceased in the spring of 1936, and the Corporation is now engaged in liquidating its loans. In all, it acquired over a million mortgages, valued at over $3,000,000,000 and representing about one sixth of the entire urban home mortgage debt of the country. Interest on mortgages in its possession is limited by law to 5 per cent; the rate has in practice been reduced to 4½ per cent.

Financial success of the HOLC's operations necessarily depended upon the extent of general economic recovery. By the very nature of its functions, its accommodation applied to homeowners considered by private institutions to be bad risks. Salvage and relief were interwoven. Serious and long-continued defaults have occurred on over 15 per cent of the refinanced mortgages. In some states, notably New York, the proportion has run as high as 30 per cent. Despite an extremely generous approach in negotiating reasonable adjustments for individual cases, the number of foreclosure proceedings has necessarily been high. By the end of 1939, 178,000 foreclosures had been authorized and 75,000 properties sold by the HOLC. Although the Corporation manages properties for a reasonable period of time in order to avoid excessive loss, it makes every effort to dispose of them as soon as market conditions permit. Losses in this respect on October 31, 1939, aggregated $67,000,000, or about 21 per cent of the book value of the properties. The HOLC's reserve for losses at that time was still $76,000,000, but it was being depleted at the rate of $15,000,000 a year. Approximately $2,000,000,000 worth of loans was still outstanding. Although officers of the Corporation still express some hope that it may eventually prove to be self-liquidating, the prospects appear very doubtful.

Operations of an agency like the HOLC place the federal government in an extremely difficult position. When general recovery

is inadequate to bring the burden of payments, even reduced by lowered interest rates, within the means of mortgagors, the government is cast in the role of the heartless creditor depriving the struggling homeowner of the roof over his head for which he has so long labored. To distinguish between willfully defaulting "chiselers" and involuntary hard cases is an invidious operation for any creditor and particularly so for the agent of a democratic government. The HOLC has attempted with considerable success to steer a difficult course between the policy of unnecessary ruthlessness, on the one hand, and the unwarranted donation of general taxpayers' funds to distressed homeowners on the other. The latter, in turn, have organized to obtain further relief through Congressional action. In 1939 they were granted, over the Corporation's opposition, a general opportunity for extension of mortgage maturities from fifteen to twenty-five years, substantially reducing the annual burden. Further proposals were made at the 1940 session for compulsory interest reductions from 4½ to 3 per cent and for a two-year moratorium on principal payments. Warnings from the Corporation of the burden these amendments would inevitably place upon the Treasury succeeded in preventing their passage. Congress will undoubtedly be faced within a few years with the need to determine clearly how far it wishes to convert the HOLC's operations into direct relief grants.

The Federal Home Loan Bank Board system, including the HOLC, served to prevent the total collapse of the mortgage market and to improve its operations for normal periods in the future. To some extent, it tended also to stimulate new construction. But counteracting factors delayed revival in the building industry at a time when other sectors of the economy were gradually resuming activity. Urban and suburban home construction totaled only 60,000 units in 1933, compared with a peak of 900,000 in 1925. The National Housing Act of 1934, substantially liberalized, modified, and extended by amendments in 1938 and 1939, was designed to meet this need. The measure was prepared after investigation by a special subcommittee of the National Emergency Council and was supported by almost all affected groups. Only recently has it begun to arouse opposition from interests fearing the adverse effect of new building on existing real estate values. Although home renovation and new housing were both considered eminently desirable in themselves, the emphasis of the legislators was on the program's

utility in stimulating employment. Housing is a strategic industry from this viewpoint. It provides a large volume of highly diversified direct employment and affords at the same time the most promising opportunity, other than rearmament, for investment on a sufficiently large scale to engender general economic recovery.

The Act of 1934 set up the Federal Housing Administration under the direction of a single administrator appointed by the President and Senate for a four-year term. The FHA is not formally incorporated. It was brought under the general supervision of the Federal Loan Agency in 1939. Its operations fall into two major classes, named for divisions of the organic Act. Title I provides for insurance of private lending institutions by the FHA against losses on loans for building repairs and, subject to a limit of $2,500 per room, for new construction. Such insurance is limited to 10 per cent (originally 20 per cent) of the loans. Until 1939, losses under title I were paid by the government as a form of subsidy, the net amount over five years aggregating about $15,000,000. The revised law now requires payment of an insurance premium by the lending institutions, which is expected to make this portion of FHA activities almost entirely self-supporting. Acceptance of such loans for insurance will cease in mid-1941, unless the period is further extended by Congress. Through October, 1939, almost 2,300,000 insured loans had been made under title I, amounting in all to over $945,000,000. All but $15,000 were for repairs rather than new construction.

The more significant activities of the FHA fall under title II. This portion of the Act established a mutual insurance system for loans on new construction of homes to be occupied by their owners. Interest rates are limited to 4½ percent (5 per cent before 1939). On property valued at less than $6,000 mortgages may be written for as much as 90 per cent of the value and carry a maturity of twenty-five years. On larger properties the limit is 80 per cent with a twenty-year maturity. Construction standards, architecture, and other factors pertinent to the soundness of the loan are rigidly scrutinized by the FHA. The insurance is complete, is carried separately for groups of loans with comparable risk and maturity, and is operated on a wholly self-supporting basis, including administrative expenses.

In case of default and foreclosure, the bank or other lending institution may transfer the property to the FHA, receiving in return government-guaranteed debentures in the name of the insurance

fund. The placing of government credit in this manner behind the new small-home mortgage market, without actual lending by the government, has proved highly stimulating to new construction. Reduced interest rates, increased amortization periods, and the high ratio of loan to total cost bring construction within the range of possibility for a whole new sector of moderate income earners. The original limit of $1,000,000,000 on the aggregate principal of insured mortgages outstanding at any one time under title II has been raised to $3,000,000,000, and may be further increased to $4,000,000,000 at the discretion of the President. Through October 31, 1939, mortgages numbering 554,000, to the amount of $2,300,000,000, had been accepted for insurance under title II, and 225,000 more, representing a further $1,000,000,000, had been selected for appraisal. Only 1,062 properties had been turned over to the Administrator. Of these, more than half had been sold at an aggregate loss of about $280,000. The insurance fund was sufficiently large to cover administrative expenses and all prospective losses with a very considerable margin to spare.

The National Housing Act also provides loan insurance to stimulate construction of large-scale rental projects for moderate income groups. Real estate bond financing had, by 1932, collapsed utterly and beyond repair from the high-flown levels of the boom era. Under the provisions of the statute, as broadened in 1938, the Administrator may insure loans for such projects up to $5,000,000 each, but not exceeding $1,350 per room, when constructed by public agencies, limited-dividend corporations, or private corporations subject to regulation by the FHA.[21] Proposed projects are given the most careful scrutiny and must demonstrate careful planning in design, in financial provision, and in proposed methods of operation. For the most part they are undertaken by private corporations with funds loaned by life insurance companies. Continuing supervision of the management is maintained through issuance of special stock to the FHA, giving it the right to select one member of the board of directors and, in case of default, to control the majority of the board. Financial reserves must be set up to assure amortization of

[21] Under Section 210, enacted in 1938, the FHA might insure loans between $16,000 and $200,000 for medium-sized rental projects. This section failed to require detailed supervision of the projects' operations and was repealed in 1939 at the request of the Administrator. During its brief history, insurance under Section 210 was granted for 112 projects, comprising 2,242 dwelling units, to the amount of $8,150,000.

the mortgage and adequate physical maintenance, thus avoiding "milking" of the property in the manner commonly practiced in the apartment-house field during the nineteen-twenties. Experience under the Act thus far demonstrates the possibility, with careful planning, of greatly improved housing conditions for middle-income families on a wholly self-supporting basis. Through October, 1939, the FHA insured 162 projects of this type for $103,000,000.

Despite its contribution to lowered cost in the small housing and large-scale renting project fields, FHA machinery left untouched the living conditions of one third to one half of the nation. Given the existing level and distribution of the national income, together with existing construction costs, a large section of the population could not obtain adequate housing without some degree of direct public assistance. Recent elaborate investigations indicate that approximately one third of the present housing units are below a reasonable standard. One sixth of the urban units require major repairs or are completely unfit for habitation. A similar proportion is seriously overcrowded. Adequate sanitary facilities are lacking in one fifth. Rural houses are in many respects in even worse condition than their urban counterparts. The needs are twofold: (1) net additions to the present housing supply for the lowest income groups and (2) replacement of slums by adequate buildings.

Total urban and suburban housing needs to meet minimum physical standards and prevent further deterioration in living conditions over the next decade are estimated at about 1,100,000 units per year.[22] In this area foreign experience emphatically confirms American evidence in pointing to the need for public enterprise if effective action is to be forthcoming. If undertaken on a large scale, moreover, the postwar British program indicates that slum clearance and low-income housing may contribute enormously to the general prosperity of the nation.

Congressional recognition of this aspect of the housing problem was first indicated by a provision in title II of the National Industrial Recovery Act of 1933, which established the Federal Emergency Administration of Public Works, for low-cost housing and slum clearance projects under public control. In 1935, the Public

[22] E. E. Wood, *Introduction to Housing Facts and Principles,* United States Housing Authority, 1940, p. 78.

Works Administration's Housing Division was authorized to grant up to 45 per cent of the capital cost of such construction. Fifty-one projects containing 21,700 units were built under this authority, but their rents still proved too high for most slum dwellers. Meanwhile, growing public support was being evidenced for adoption of slum clearance and low-rent housing as a permanent federal policy. Under the leadership of Senator Wagner of New York, a measure to this effect was adopted in the late summer of 1937.

The United States Housing Act of 1937 stated the intent of Congress in the following terms:

> to promote the general welfare of the Nation by employing its funds and credit, as provided in this Act, to assist the several States and their political subdivisions to alleviate present and recurring unemployment and to remedy the unsafe and insanitary dwellings for families of low income, in rural or urban communities, that are injurious to the health, safety, and morals of the citizens of the Nation.

To administer this policy it created as a body corporate "in the Department of the Interior and under the general supervision of the Secretary thereof" [23] the United States Housing Authority, directed by a single Administrator with a five-year term. The Authority's capital of $1,000,000 was subscribed by the Treasury. Its operating funds are obtained through the issuance of fully guaranteed notes or bonds. The limit of $500,000,000 for such obligations was raised in 1938 to $800,000,000. With these funds the USHA makes loans on a fully repayable basis to state or local public housing agencies for slum clearance and low-rent housing construction which meets its standards. The loans may run for as long as sixty years and must carry interest at the "going federal rate" plus ½ per cent.[24] Ten per cent of the construction cost must be supplied by the local authority, either through services or in cash.

The law goes beyond the use of government credit to obtain low interest rates; it also provides for an annual subsidy which may amount to as much as the going federal rate of interest on the con-

[23] In 1939 the USHA was transferred from the Interior Department to the newly created Federal Works Agency.

[24] The going federal rate is defined as the rate on the most recently issued government bonds with a maturity of ten years or more. USHA loans to local housing authorities have, in fact, been either at 3 or 3¼ per cent.

struction loan plus 1 per cent. The combination of loan and subsidy provisions produces a federal contribution equivalent to ½ per cent in addition to the remission of interest. The subsidy may not exceed the amount necessary to assure the low-rent character of the particular project, and is to be reviewed after ten years and every fifth year thereafter. The local authority must also make an annual contribution of at least one fifth the federal subsidy. The sum of $28,000,000 a year was authorized toward annual subsidies. Construction costs are generally limited to $1,000 per room and $4,000 per family unit, but in large cities the limits are set at $1,250 and $5,000 respectively. Tenants for USHA projects must be selected from families in the lowest income group "who cannot afford to pay enough to cause private enterprise . . . to build an adequate supply of decent, safe, and sanitary dwellings for their use." Their net income must not exceed five times the rental except for families with three or more children, when it must not exceed six times the rental. The USHA also administers the projects constructed by the PWA Housing Division, disposing of them as soon as possible to local housing authorities through sale or lease. More than half of these projects have now been transferred.

All the available funds of the USHA were committed within two years after its creation. By November, 1939, contracts were made for 296 projects containing 114,356 units and involving loans of over $521,000,000. Tentative allocations covered a further $157,000,000. Since annual contributions on this capital sum exhausted the entire authorization, it was, in fact, impossible to provide loans out of the remaining $130,000,000. In the 1939 session of Congress the Authority sponsored a bill for an additional $800,000,000 loan authorization and an increase of annual contributions to $45,000,000. It was reported favorably in both Houses and passed the Senate by a vote of 48 to 16. In the House, however, the economy bloc succeeded in rejecting this proposal, by a vote of 191 to 169. The pressing needs of housing in defense industry areas under the expanded armament program of 1940 are being met, in part, through USHA loans out of defense funds. The long-run future of peacetime slum clearance and low-rent housing construction, however, remains in doubt. The present program of the USHA affects about 650,000 persons; the expansion proposed in 1939 would have included a further 1,500,000. Even had the latter been adopted, the total would fall far short of demonstrated needs.

CONCLUSION

Expanded use of government credit, undertaken in the first instance to prevent total collapse of the national debt structure at the pit of the Great Depression, now seems likely to remain a permanent field of public activity. It is noteworthy that these lending operations, except for the HOLC, the USHA, and portions of the agricultural credit system, are conducted with profit to the government. Public enterprise of this type, particularly in agriculture and housing, appears to fulfill a demand left unsatisfied by the private credit structure. It carries with it two significant implications for the future position of government in the economy. Participation in capital supply gives to public agencies direct influence upon economic policies of the businesses concerned, and may provide an efficient means for their regulation. At the same time, choice of objectives for the application of public credit invests government with a large and sometimes decisive role in guiding the flow of investment funds. It thereby influences at a strategic point the dynamics of the economy for the future.

4. The Mixed Corporation

An effort is sometimes made to fuse the respective advantages of government and private ownership by establishing jointly owned corporations, directed by boards representing both private and government stockholders. The term "mixed corporation" is applied to organizations of this type. The category comprises a wide variety of arrangements. Policy and operations will depend vitally upon the relative extent of government and private participation. Majority public control may be employed only for special regulatory purposes, with operations left for the most part to representatives of the private stockholders, or it may make the undertaking almost indistinguishable from wholly public enterprise. The government as minority stockholder may go wholly unrepresented on the board, simply supporting the capital structure and receiving dividends, or it may obtain special privileges under the terms of the charter. In general, the form and conditions surrounding a given mixed corporation are a function of the particular circumstances determining its establishment.

On the European continent, particularly in Germany, mixed cor-

porations have been extensively used for more than fifty years. They play a large part in the electricity, gas, local transportation, housing, and mining industries. The "compagnie nationale," a type of mixed corporation, was developed in France after the first World War for subsidization of special industries, including aviation, shipping, and water-power development. In the English-speaking countries, on the other hand, the device has been employed only rarely. A handful of instances may be found in Great Britain and the Dominions. They include the Bank of Canada, the South African Iron and Steel Industrial Corporation, the Anglo-Iranian Oil Company, and Imperial Airways. In the United States, the Federal Intermediate Credit Banks and Federal Home Loan Banks fit formally into this category, but government participation is viewed merely as a transitional stage to ultimate ownership by member institutions.[25] Many private concerns are technically taking on the form of mixed corporations through stock participation by the RFC. Thus far, however, the Corporation has not attempted to influence their operating policy to a greater extent than would any large creditor. Participation of the FHA in special corporations set up for large-scale rental projects is a more significant use of the form.

The most celebrated American examples were the First and Second Banks of the United States. In the case of the latter, which operated from 1816 to 1836, the government subscribed $7,000,000 out of the $35,000,000 capital and appointed five of the twenty-five directors. In that historic instance, public participation not merely failed to harmonize Bank policy with general public policy; the government and the Bank became positively hostile to one another. After an epic battle with President Jackson, the Bank's life was terminated. Effective governmental knowledge of its activities was avoided by secret meetings of the private directors.

Mixed corporations are used most commonly as a means of promoting the development of important new enterprises or of providing a government subsidy to "sick" industries. They sometimes serve as a regulatory device, guarding against abuse of monopoly power or furthering some other general policy. In some instances, they have been substituted for purely public enterprise in order to

[25] An earlier example of government participation in the initiation of an important enterprise, which later became wholly private, is afforded by the Union Pacific Railroad. See above, p. 232.

discourage political interference with day-to-day operations. Where a majority of mixed corporation stock is in public hands, it is generally difficult to obtain private equity capital on reasonable terms. The controlling interest of government is not often devoted to the pursuit of maximum profit; private capital is, therefore, loath to share in the risk of the enterprise. In exceptional instances, in which precise limits to public influence on corporation policy are stipulated, mixed corporations with majority public participation may prove successful. In the case of the Anglo-Iranian Oil Company, the British Government owns £7,500,000 out of the £13,425,000 of common stock, but appoints only two of the fifteen directors and restricts its control to matters of foreign, naval, and military policy. There is no interference in ordinary management. Under these circumstances Anglo-Iranian stock has proved reasonably popular on the London market. Ordinarily, however, mixed enterprise with the government predominating is transitory; it tends to become transformed into purely public enterprise.

Mixed corporations in which private stockholders predominate have more fruitful possibilities. The presence of government directors on the board may provide a more effective means of continuing regulation than outside agencies coming into operation only after complaints of malfeasance. To be effective, however, such participation must be supplemented by special authority for the government directors, which sets the framework within which the impact of public policy will operate. Without such authority, the form is likely to repeat the unhappy example of the Biddle-Jackson battle over the Second Bank of the United States. As yet only in its infancy in this country, the mixed corporation may well find considerable employment in sectors of the economy where neither wholly private enterprise nor its complete displacement by government meet the needs of policy.

5. Public Enterprise and General Economic Policy

As the scope of public enterprise broadens, it impinges with increasing force upon the economy as a whole and demands correlation with other elements of public policy. Municipal water supply may be undertaken as an isolated function of government without significantly influencing the remainder of the economic order. But when transportation, power, housing, and large-scale credit opera-

tions come within the public sphere, the governmental sector bulks large in the total economy. Policy pursued in one field ramifies everywhere and reacts back upon the government itself in its other capacities. Hence the pressure for reintegration of public corporations into the general administrative framework, in an effort to ensure consistency in over-all policy while maintaining the demonstrated advantages of administrative flexibility and autonomy derived from the corporate form.

Beyond the requirements of internal harmony among the administrators of public policy, whether organized in promotional, regulatory, or operating agencies, lies the significance of the increased scope of all three types of activity taken in conjunction. The growth of public enterprise marks most sharply a shift in motivation from mere elimination of abuses to satisfaction of positive demands. The changing pattern of promotion and regulation follows the same trend. Particular policies arise one by one out of special demands and pressures of the moment; their sum effect is to transform the role of government from partial rule maker and haphazard intervener in the economic process into continuous participant and guide. The trend of recent decades has given to governments throughout the world an increasing initiative in major economic decisions; it has tended to make them conscious directors of the form of economic development.

Chapter Twenty. CONSERVATION OF NATURAL RESOURCES

"Conservation," says a recent report of the Interior Department, "is the management and wise use of the natural assets to prevent their depletion and at the same time produce wealth." [1] In its early development, the concept of conservation was limited to maintaining renewable resources and eliminating avoidable waste of nonrenewable resources. In the first classification, destruction of forest reserves occasioned the greatest concern; in the second, mineral losses, dramatized by burning fields of oil and natural gas, brought about a demand for conservation. The term subsequently expanded with regard both to the subjects of conservation and the types of policy included within its scope. It now includes the prudent development and utilization of resources of all types for the satisfaction of maximum social needs.

To prevention of waste and depletion has been added avoidance of waste by nonuse or inferior use. The development of water power, the encouragement of heating and cooking uses for natural gas in place of its employment in the manufacture of carbon black, irrigation in the arid and semiarid areas, protection against floods, and even the development of water transportation, are all now considered appropriate conservational objectives. No simple definition can be found sharply marking the boundaries of "conservation." The stress, however, is upon two basic elements: (1) the adjustment of the natural environment to human requirements and (2) the achievement of a reasonable balance between the present and future needs of society.

[1] *Why a Department of Conservation,* S. Doc. 142, 75th Cong., 3rd Sess., 1938, p. 3.

Taken in this sense, conservational activities are a peculiarly appropriate subject of governmental action. Except in the narrow domain of immediate family interest, concern for the distant future will rarely be translated into effective action except by public agencies. Experience conclusively indicates that unmodified competitive forces do not provide adequate safeguards against the depletion of natural resources at a rate and in a manner threatening the basis of security for future generations, or even for immediately succeeding decades. In the exploitation of natural resources, moreover, the individual's balance sheet rarely takes account of full social costs and benefits. The careless stripping of forests from upland slopes in a given region, for example, may, in turn, destroy adjacent farm land by soil erosion, pollute the valley waters with the resultant silt, and shorten the useful life of an expensive downstream dam structure by rapid siltation of the reservoir. The ultimate costs and damages imposed upon others may far exceed the profits of the lumberman. Yet, without public intervention, such costs and damages will play no part in determining his course of action. American land tenure conditions and traditions have been unusually conducive to rapid exploitation and "mining" of the renewable as well as the nonrenewable resources.

Both the abuses of the natural environment and the development of a specific conservation movement have been largely conditioned by the unique circumstances of American land settlement. By far the greater part of the nation's land was held at one time as public domain. A policy of utmost encouragement to rapid settlement and unrestricted immigration, applied to unrivaled natural conditions, produced the unique phenomenon of the American frontier, with its legend of inexhaustible resources and its intransigent individualistic philosophy. For a century the federal government was first and foremost a giver of gifts, and the largest element of its bounty was the public lands. The lands were distributed without any attempt to control their future use. The policy succeeded in developing the continent at a rate attained nowhere else on the surface of the earth, but it brought in its train physical wastage and political corruption equally unparalleled in scale.

As the best lands in government possession finally came to an end at the close of the nineteenth century, and as shortages in specific resources began to threaten, a reaction in public sentiment set in. The idea of imposing social restraints upon unlimited ex-

ploitation of natural resources, however, ran counter to a century-old tradition, as well as to organized particular interests with enormous immediate gains in sight from continuance of the old order. Forging of the conservation movement into a political cause sufficiently powerful to achieve significant results was accomplished only at the beginning of the twentieth century.

1. The Conservation Movement

Concern over the rate of exploitation of our natural resources was expressed in the first instance by geographers, geologists, foresters, and other scientific observers in the decades immediately following the Civil War. Eastern experience with forest destruction, water pollution, and wild life extinction suggested to these specialists the danger of parallel abuses and ultimate shortages in the West. Representations to Congress in this connection were made during the seventies by the American Association for the Advancement of Science and the newly organized American Forestry Association. The celebrated report of Major J. W. Powell of the United States Geological Survey on *Lands of the Arid Regions of the United States,* submitted in 1878, stimulated interest in systematic land classification and the needs of irrigation.

These forebodings of future evils, however, coincided with the most hectic land boom of American history. An earlier tradition of disposition of the public domain by sale (at nominal prices, to be sure) was displaced during and after the Civil War by a policy of gifts—grants to states, to railroads, and to private individuals. The General Land Office viewed its function as the most rapid possible transfer of the areas within its control to private hands. While preference was nominally given to the establishment of permanent homes for farm families, actual administrative practice also relinquished every type of resource—land, forest, mineral, and later water power—to corporate interests as well. The possibility of permanent retention of natural resources for management under public supervision, either by lease or by direct public enterprise, was hardly seriously considered, for it ran directly counter to the dominant philosophy of the period.

Against the momentum of feverish exploitation, the warnings of scattered scientific Cassandras made but little headway. A policy of reservation of public lands, which had been applied until 1845 in

connection with mineral properties, but subsequently abandoned, was reinstituted for limited purposes. Thus, Yellowstone National Park was created in 1872. Presidents were authorized to withdraw from entry irrigation reservoir sites in 1888 and forest lands in 1891. Under the latter authority, Presidents Harrison, Cleveland, and McKinley created forest reservations totaling some 45,000,000 acres. During the same period, most of the states undertook scattered action to protect wild life, to prevent the more obviously destructive forest malpractices, and to reduce oil, gas, and other mineral wastage.[2]

The sum effect of such measures, while not inconsiderable, was far from constituting an effective, comprehensive program. With the frontier at an end and the consequences of unrestrained exploitation obtruding themselves with increasing force upon the popular consciousness, an eventual trend toward conservation was probably inevitable. But it would almost certainly have been seriously delayed in obtaining substantial results without the enlistment of Theodore Roosevelt's crusading zeal. Roosevelt, in turn, was inspired primarily by Gifford Pinchot, who had been appointed Chief of the Forestry Bureau in the Department of Agriculture in 1898. Pinchot was probably more largely responsible for the widespread public interest in conservation early in this century than any other single individual. Conservation became a watchword of the Roosevelt Administration. Its support was shortly to be taken as a touchstone of progressivism within the Republican Party.

The new development took three forms: (1) popularization, which welded scattered enthusiasts into a national movement; (2) systematic surveying of natural resources and planning for their interrelated development; and (3) reservation of great areas of the remaining public domain and assumption of federal responsibility on an unprecedented scale for natural resource preservation and development.

In his first annual message to Congress, Roosevelt declared that "the forest and water problems are perhaps the most vital internal problems of the United States." Under the Reclamation Act of 1902, the federal government undertook development of irrigation projects in the Western states. The forest reserves were increased to

[2] An unusually thorough assemblage and discussion of state conservation experience may be found in C. J. Hynning, *State Conservation of Resources,* published by the National Resources Committee, 1939.

150,000,000 acres, including practically all important forest lands still within the public domain. Public coal, oil, and phosphate lands were also withdrawn from entry, together with a number of sites for water-power development. The Inland Waterways Commission, appointed in 1907, laid down for the first time the principles of interrelated, multiple-purpose water resource development which have become the kernel of modern water conservation policy. Out of its recommendations grew the celebrated White House Conference of Governors, the first gathering of its type, which was held in 1908. Enormous impetus was given to state conservation activities. A National Conservation Commission was established by the President to draw up a general inventory of the nation's natural resources as a basis for further policy formulation. At the same time the Geological Survey began systematic classification of the remaining public lands.

In the political sphere, Roosevelt's enthusiasm for conservation was closely associated with his campaign against monopolistic corporations. Wholesale withdrawals of public lands engendered fierce hostility to the program among well-entrenched lumbering, mining, and power interests. They received substantial support from wider groups in the Western states who were alarmed by the threat of permanent loss of large areas from their tax jurisdiction. Before the close of Roosevelt's term, a reaction in Congress set in which severely curtailed the work of the Conservation Commission and forbade further forestry withdrawals without specific legislative consent.

President Taft, while sympathetic to conservation ideals, did not approach the subject with the vigorous enthusiasm of his predecessor. Important mineral lands and water reserves were withdrawn during his Administration, but the tempo and intensity of the movement were sharply decreased. In the public mind the reaction was emphasized by the dramatic quarrel between Pinchot, who had been placed in charge of the national forests since their transfer from the Interior to the Agriculture Department in 1905, and Secretary of the Interior Ballinger. Pinchot charged the Interior Department with serious corruption in connection with Alaskan coal lands; President Taft, concluding upon investigation that the charges were unwarranted, removed Pinchot from office. Ballinger, although exonerated by an official inquiry, resigned under a cloud shortly thereafter.

Conservation thus became a political football in the widening schism in the Republican ranks. In the struggle between the Departments of Agriculture and Interior over the appropriate location of national forest control—a controversy which persists to this day—the momentum of the movement was seriously slackened. Like many public policies initiated in the heat of intense, widespread, temporary excitement, conservation suffered from the absence of a solid core of continuing interests devoted to its maintenance. Nonetheless, by the close of the Taft Administration, the objective of natural resource conservation had become in principle an accepted and permanent function of American government.

During the first World War and postwar periods, substantial, although undramatic, advances were made in the clarification of conservation policy. Supervision of water-power development within the scope of federal jurisdiction was provided by the Federal Water Power Act of 1920. At the same time, measures were enacted for supervised operation of coal and oil recovery from public lands under a leasing system. Further substantial areas of the public domain were withdrawn from entry by every President. Increasing attention was given to demonstration, research, and assistance to the states in promoting conservational practices on private lands. For a time, during the Harding regime, doubt was cast upon the integrity of the administration of reserved public lands by the Teapot Dome oil-lease scandal.[3] On the whole, however, the period was one of slow but steady development toward effective conservational techniques.

With the deepening of the Great Depression, and the election to office of President Franklin Roosevelt, conservation activities were restored to a position of prominence reminiscent of the new President's namesake. In this revival, a leading part was played by the desire for useful public works, noncompetitive with private enterprise, as a means of unemployment relief. Conservational activities of one form or another became a primary objective for the Public Works Administration, the Work Projects Administration (and its various predecessors), and the Civilian Conservation Corps. A

[3] This scandal arose from the granting of leases in the Wyoming Naval Oil Reserve to private interests on unduly generous terms. A number of high government officers, including members of the Cabinet, were accused of flagrant corruption in connection with the transactions and the leases were later canceled by the Supreme Court.

comprehensive survey of natural resource policy in relation to potentially useful public works was undertaken in 1934 by the National Resources Board. Interest was further intensified by the critical needs of sections of the farm population which were now unable to find employment in urban centers. In 1934, dramatic emphasis was given to the disastrous results of soil erosion by the dust storms which arose from the northern Great Plains.

Under these conditions, the conservation movement resurged to the highest point of its development. Large-scale measures for soil erosion control were undertaken. The entire remaining public domain was withdrawn from entry. Through tax reversions and purchases, its area was even somewhat increased. Of the greatest significance, perhaps, was the resumption, expansion, and elaboration of efforts at systematically planned natural resource development with relation to long-term human needs.

2. Major Spheres of Conservation Policy

During its brief forty-year span, the major emphasis of the American conservation movement has been concentrated on the public domain. Of the original area approximating 1,700,000,000 acres, some 680,000,000 acres remain in public hands. Excluding the 240,000,000 acres in Alaska, about 35 per cent of the remainder is included in national forests, 12 per cent in Indian reservations, 5 per cent in miscellaneous classified reservations of other types, and almost half in lands unappropriated for special purposes but withdrawn from entry in 1935. Administration of reserved areas for particular conservational purposes has provided a field of experimentation for management practices often applicable to private properties as well.

In the last decade, greatly increased attention has been devoted to the development of conservational policy for natural resources in private hands. Education, demonstration, pecuniary persuasion, and legal regulation have all been marshaled to this effect. In some areas, notably forestry, conservationists have expressed serious doubts concerning the possibility of effective action without a substantial increase in public ownership. In others, among which soil and mineral conservation are outstanding, large-scale public ownership is regarded as neither feasible nor desirable. The creation of

administrative machinery and techniques for co-operative public and private endeavor in promoting the ends of conservation is still in a formative stage.

Although conservation policy extends, in greater or less degree, to every phase of natural resource use, including recreation, mineral extraction, and wild life protection, the treatment here will be limited to a survey of problems and policies in three outstanding sectors: forest, soil, and water resources.[4]

FORESTS

Forest resources were the primary concern of the original conservation movement and retain a central position in conservation policy. They are closely related to a wide range of other natural resources. Watershed protection and soil erosion control both depend in large measure upon related forest activities. Forests contribute to wild life preservation and to recreation. But the principal source of conservational interest in forests arises from their intrinsic importance as the raw material for a series of major industries. Although a renewable resource, the necessary time span for full renewal is long. Only in very exceptional cases are private lumbering operations conducted upon a permanent sustained yield basis. The general rule has been logging of particular areas and subsequent abandonment, often followed by complete destruction through fire and insects. Yet, during the period of large-scale lumbering, local communities become directly or indirectly dependent upon these operations. Forest depletion brings in its train unemployment, the drying up of tax revenues, and community impoverishment. The cutover lands in the northern Great Lakes states and portions of the Pacific Northwest afford striking examples of this process.

[4] Except with regard to the mineral fuels (coal, oil, and natural gas), which are treated in Chapter 17, conservation policy has been least highly developed with regard to minerals. Research and assistance in methods of prospecting, recovery, and utilization are provided by the United States Geological Survey, the Bureau of Mines, and corresponding agencies in all the mining states. In connection with the current national defense program, attention has been focused upon stimulating the provision of domestic sources for relatively rare minerals essential to defense industries, as well as to the accumulation of stock piles through importation from abroad. By and large, however, in the words of the National Resources Board: "Minerals, from the standpoint of public attention, have been a neglected natural resource." National Resources Board, *Report on National Planning and Public Works,* 1934, Part IV, *Report of the Planning Committee for Mineral Policy,* p. 439.

Moreover, although the substitution of other materials for wood, together with the declining rate of population growth, has somewhat diminished the markets for lumber, the traditional cutting practices threaten grave shortages on any reasonable estimate of future demand.

Of an original forest area of 915,000,000 acres, almost one third has been cleared for agricultural and other uses, so that about 630,000,000 acres remain. Somewhat less than three quarters of this area is suitable for commercial timbering; the remainder can be used only for watershed protection, grazing, wild life, and recreation. The national forests comprise about one fifth of the total forest area, including 19 per cent of the commercial and 27 per cent of the noncommercial sector. State and local authorities hold only a small proportion of the remainder. Owing to rapidly mounting tax delinquencies, their forest acreage is gradually increasing, but it consists for the most part of lands in exceedingly poor condition.[5] Of the private commercial woodlands of 374,000,000 acres, about two fifths is to be found in farm wood lots and the remainder in commercial ownership. Despite the substantial proportion of forest land held by the national government, its timber production is kept at a minimum, amounting in 1938 to less than 3 per cent of the nation's total. Thus, the forest conservation problem remains predominantly one of management in the private sector.

The greater part of the present national forest land was reserved from the public domain by Theodore Roosevelt and his predecessors. It consists of about 175,000,000 acres, including 41,000,000 acres of grazing and alpine lands not suitable for forest growth. The Weeks Act of 1911 permitted the Forest Service to acquire "such forested, cutover, or dead wood lands within the watersheds of navigable streams as . . . may be necessary to the regulation of the flow of navigable streams," and the McNary-Clarke Amendment of 1924 authorized further purchases of such lands for the production of timber. Under this authority the national forest system has been extended to some 17,000,000 acres in the Eastern states, in

[5] Under the provisions of the Fulmer Act of 1935, the federal government may advance up to $5,000,000 per year to the states for the purchase of forest lands. Half the gross proceeds of sales of forest products from such lands are to repay the federal government until the entire advance is reimbursed, but without interest. To qualify for the benefits of the Act, a state must conform with specified forestry management principles. It is expected to build up in this manner an eventual state forest system of about 30,000,000 acres.

which the entire public domain was long ago transferred to private hands. Exchanges and donations, the latter chiefly in scenic areas, also provide small additions from time to time.

National forest management is devoted primarily to maintenance of existing stands and restoration of growth on cutover or otherwise depleted areas. Carefully organized fire protection results in a substantially smaller proportion of loss than on private lands. The program includes large-scale planting and nursery operations. A limited amount of commercial timbering is permitted by private operators under close Forest Service supervision. Since the more valuable commercial timberlands in the public domain were disposed of prior to the initiation of conservation policy, the national forests are, for the most part, relatively inaccessible. It is estimated that "only about one third of the saw timber now in National Forests could be logged at a profit under present marketing and operating conditions." [6] Moreover, since the rate of depletion substantially exceeds that of growth on private lands, and a large share of the private industry faces declining markets and increasing costs, the government has discouraged lumbering from publicly owned areas both as a matter of economic policy and in order to provide reserves for the future. Cutting on a sustained yield basis within the national forests is limited at present to 33,000,000 acres under extensive management and about one tenth that area under intensive management. While almost negligible commercially, these operations provide an important laboratory for the development of scientific forest management practices. Receipts from timber sales, grazing fees, and other miscellaneous sources yield some $6,000,000 per year, about half the cost of administration of the national forests.

In addition to managing the national forests, the United States Forest Service promotes conservational activities by the states and by private forest owners. Under the McNary-Clarke Act of 1924, federal funds are made available for aid in fire prevention and afforestation. Assistance is also afforded to individual farmers in managing their wood lots. In addition, the Service engages in promotional and research work in forest economics and forest product utilization.

The present area of woodland is considered ample under proper

[6] *Report of the Chief of the Forest Service to the Secretary of Agriculture*, 1939, pp. 40–41.

management to provide all foreseeable forest demands, including a reasonable export surplus. Nevertheless, despite substantial improvement during the past forty years both in fire and disease prevention and in scientific forestry, the current annual drain still substantially exceeds the annual growth. The ratio is particularly high for saw timber. Faced with market declines consequent upon the depression, many industrial lumber concerns have sought to liquidate their heavy capital investments in the shortest possible time. Economic pressures have prevented others from assuming the costs of long-run sustained yield management, regardless of future consequences. Existing local taxation methods intensify the pressures for rapid liquidation. On farm wood lots scientific management may be expected only with guidance from expert public agencies.

During the past decade, the entire field of forest resource policy has come under public review. In 1932 the Senate, finding that "the consumption of the forests of the United States has progressed to a point at which their early exhaustion is threatened," requested the Forest Service to report on the desirability of further federal aid to the states for improved utilization of forest lands. An elaborate report was submitted in the following year under the title *A National Plan for American Forestry*. The report was highly critical of private forestry practices, finding that "they have been very seriously detrimental to the owners and the forest industries, to the productivity of the forest, and to the public interest. Constructive management is conspicuous largely by its absence, except in fire protection." [7] It proposed an addition to existing public forest areas of over 200,000,000 acres, leaving 155,000,000 acres in industrial ownership, and 100,000,000 acres in private farm wood lots. Increased public aid in promoting fire protection and improved management in the private sector was also recommended, while the possibility of state regulation of cutting practices was tentatively suggested. In the face of severe opposition to the more far-reaching proposals, only a moderate acceleration of the national forest purchase program, together with a limited program of federally aided state purchases, was approved by Congress.

Public attention was again called to the need of a comprehensive forestry policy by a message from the President to Congress in the spring of 1938. On his recommendation, a Joint Congressional

[7] *A National Plan for American Forestry*, S. Doc. 12, 73rd Cong., 1st Sess., 1933, p. 58.

Committee was established to study the problem of the "unbalanced forest budget," with particular reference to:

(a) The adequacy and effectiveness of present activities in protecting public and private forest lands from fire, insects, and diseases, and of co-operative efforts between the Federal Government and the States.

(b) Other measures, Federal and State, which may be necessary and advisable to insure that timber cropping on privately owned forest lands may be conducted as continuous operations, with the productivity of the lands built up against future requirements.

(c) The need for extension of Federal, State, and community ownership of forest lands, and of planned public management of them.

(d) The need for such public regulatory control as will adequately protect private as well as the broad public interests in all forest lands.

(e) Methods and possibilities of employment in forestry work on private and public forest lands, and possibilities of liquidating such public expenditures as are or may be involved.

(f) The need for additional legislation, authorizations, appropriations, research, and other measures to insure adequate administration and development of the forest lands in Federal ownership.[8]

Hearings were held by the Committee in all important forest sections of the country and testimony was received from federal, state, and local officials, representatives of the lumber industry, and other parties-in-interest. The Forest Service amplified its proposals of 1933 to include comprehensive regulation of cutting practices on private lands by co-operative state-federal action. An enlarged program of public acquisitions received support from all interests. Warm controversy remained, however, regarding the areas to be acquired and the future relations between public and private forest enterprise. The Committee faced a difficult task of reconciling an unusually complex tangle of interests. New organic legislation on a broad scale was expected after submission of its report.

SOIL CONSERVATION

The weakening of the basis of agricultural prosperity through soil erosion, together with the exhaustion of soil fertility, has attained recognition in recent years as the most urgent single problem facing American conservation policy. "It is doubtful whether any other long-time social loss is so great as the loss caused by destruc-

[8] Joint Committee on Forestry, *Hearings on Forest Lands of the United States*, 75th Cong., 3rd Sess., 1939, Part 1, p. 4.

tive exploitation of soil, the result of unlimited competition for short-time individual advantage in the 'mining of the land.' "[9]

An erosion reconnaissance survey made by the Department of Agriculture in 1934 indicated that over 57,000,000 acres had been essentially destroyed for tillage and that 225,000,000 additional acres were severely eroded. Moderate erosion extended to a further 775,-000,000 acres, while only 700,000,000 acres were more or less unaffected. The problem varies in intensity in different regions. Water-induced sheet and gully erosion is most severe in the South, while wind erosion is extremely serious in the northern Great Plains. The consequences for individual farmers range from moderately reduced crop yields, and increasing requirements of fertilizer, to total abandonment and migration away from particular areas. Soil erosion also affects a variety of water resource problems, since it intensifies the severity of floods, produces siltation of navigable streams, and destroys river control reservoirs.

The types of remedial action required to reverse the processes of soil depletion and erosion are by now well known in their broad outlines. In general, they involve retirement from agricultural use of an area approaching 100,000,000 acres, substitution of soil-building for soil-depleting crops, systematic crop rotation, prevention of overgrazing on range lands, supply of additional water in semiarid areas, afforestation to check the rate of water runoff, mechanical checks to rapid runoff, construction of windbreaks, cultivation of sloping land along the contours, and a host of other similar practices. Only a beginning, however, has been made in the practical application of such remedies. It constitutes perhaps the leading potential field of fruitful endeavor for large-scale public enterprise over a period of many decades.

Government research into the extent of soil depletion and into preventive and remedial action has been carried on for many years. Through demonstrations and educational efforts the Department of Agriculture has promoted soil conservational activities by individual farmers. In the depressed economic position of most American agriculture since the first World War, economic pressures have generally been too severe to permit individuals to undertake remedies on a voluntary basis. The conditions of farm tenure and the tradition of rapid turnover in ownership have also been deterrents to individual conservation.

[9] Department of Agriculture, *Agricultural Adjustment, 1937–1938* (1939), p. 36.

The adoption of an agricultural program affecting individual farm production in 1933 afforded an opportunity for public action to promote soil conservation as well. An emergency erosion control program was authorized in title II of the National Industrial Recovery Act. In consequence of the appalling dust storms of 1934, the Soil Erosion Act was adopted by Congress in 1935. It was declared to be national policy "to provide permanently for the control and prevention of soil erosion and thereby to preserve natural resources, control floods, prevent impairment of reservoirs and maintain the navigability of rivers and harbors, protect public health, public lands, and relieve unemployment." The Department of Agriculture was given general authority to conduct investigations in the field of soil erosion, to carry out preventive measures, to cooperate with other government agencies, federal, state, and local, and to acquire lands for the purpose of erosion prevention. The Soil Conservation Service was established within the Department to carry out the provisions of the Act and a substantial volume of Civilian Conservation Corps and Works Progress Administration labor was assigned to soil conservation operations.

Invalidation of the Agricultural Adjustment Act of 1933 in the Supreme Court's *Hoosac Mills* decision, handed down in 1936, led to emphasis upon soil conservation as the core of the agricultural control program. Production control was tied to this broader objective through the Soil Conservation and Domestic Allotment Act of 1936, which took the form of an addition to the Soil Erosion Act of 1935. Payments to individual farmers were now based primarily upon the substitution of soil-building for soil-depleting crops, and the adoption of soil-conserving farm practices. Although improvement in agricultural income was undoubtedly the primary objective of the new legislation, this end was effectively combined with the promotion of conservation. The provisions were continued and strengthened in the Agricultural Adjustment Act of 1938.

In the administration of its soil conservation program, the Department of Agriculture has emphasized utmost decentralization and acceptance of maximum responsibility by individual farmers. On the Department's recommendation, three fourths of the states have enacted legislation to authorize the formation of special local government units, known as soil conservation districts. The districts supplement other aspects of the soil conservation program and constitute an administrative device of great potential significance.

Through co-operative action with appropriate federal and state agencies, they assume a substantial share of the difficult burden of translating broad national objectives into plans for individual action. More specifically, their purposes have been described as "control of soil erosion, establishment of economic farm and ranch units, adjustments in taxation, stabilization of land use, development of proper tenant and landlord relationships, arrangement of suitable agricultural credit, fostering of satisfactory home and community relationships." [10]

Another phase of soil conservation, in which action on public lands is of particular importance, arises from the overgrazing of Western ranges. Until 1934, unappropriated areas in the public domain were held as a grazing common, unfenced and wholly without public control. The consequences were strikingly summarized by President Hoover's Committee on Conservation in the Public Domain:

> Today overgrazing has taken its toll in the form of large areas unfit for grazing, or greatly reduced carrying capacity for livestock generally. Erosion has been increased by the destruction of forage cover, and the silting of stream and river flow as an aftermath has added to the problems of ranch and farm reclamation. The damage done may never be wholly repaired, nor yet its progress wholly arrested, but as a continuing evil it may be diminished, and by proper scientific treatment and regulation many ranges may be steadily improved and carrying capacity increased.[11]

The Taylor Grazing Act of 1934 boldly attacked this problem by authorizing withdrawal from entry of 80,000,000 acres for the constitution of grazing districts. The area was extended in 1936 to 142,000,000 acres. The Interior Department was given full authority to control grazing practices in such districts, "to regulate their occupancy and use, preserve the land and its resources from destruction or unnecessary injury, to provide for the orderly use, improvement, and development of the range." By 1939, fifty grazing districts had been established, including virtually the entire area authorized by the Act. Livestock owners were permitted to utilize the land only under short-term licenses and permits, designed to en-

[10] *Annual Report of the Secretary of Agriculture,* 1939, p. 51.

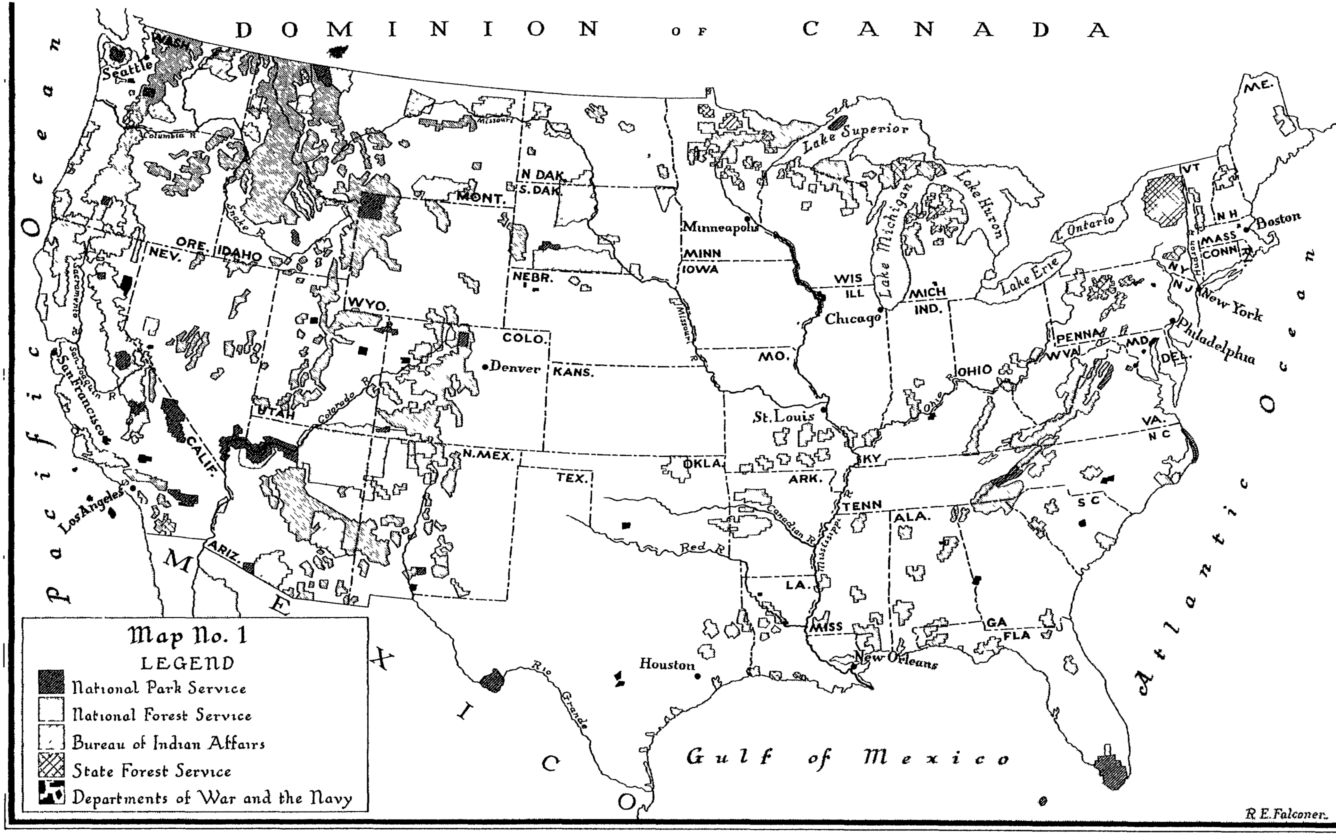
[11] *Report of the Committee on the Conservation and Administration of the Public Domain,* 1931, p. 13.

sure limitation of grazing to amounts supportable by the forage cover and to permit restoration of the natural cover on previously overgrazed areas. Water-control devices were constructed to improve distribution of the limited water supply over the public range. Grazing fees net a substantially larger annual yield than the administrative costs of the Division of Grazing. A similar permit system was applied by the Forest Service to grazing within the national forests.

Over the entire scope of soil conservation activities, water control plays an important role. Optimum distribution of the limited water supply in the arid and semiarid areas of the West is an essential prerequisite to proper land use. In the easterly regions with more heavy rainfall, soil erosion, flood control, and afforestation are mutually interrelated. Land and water conservation policies, in consequence, necessarily overlap over a wide zone.

WATER RESOURCES

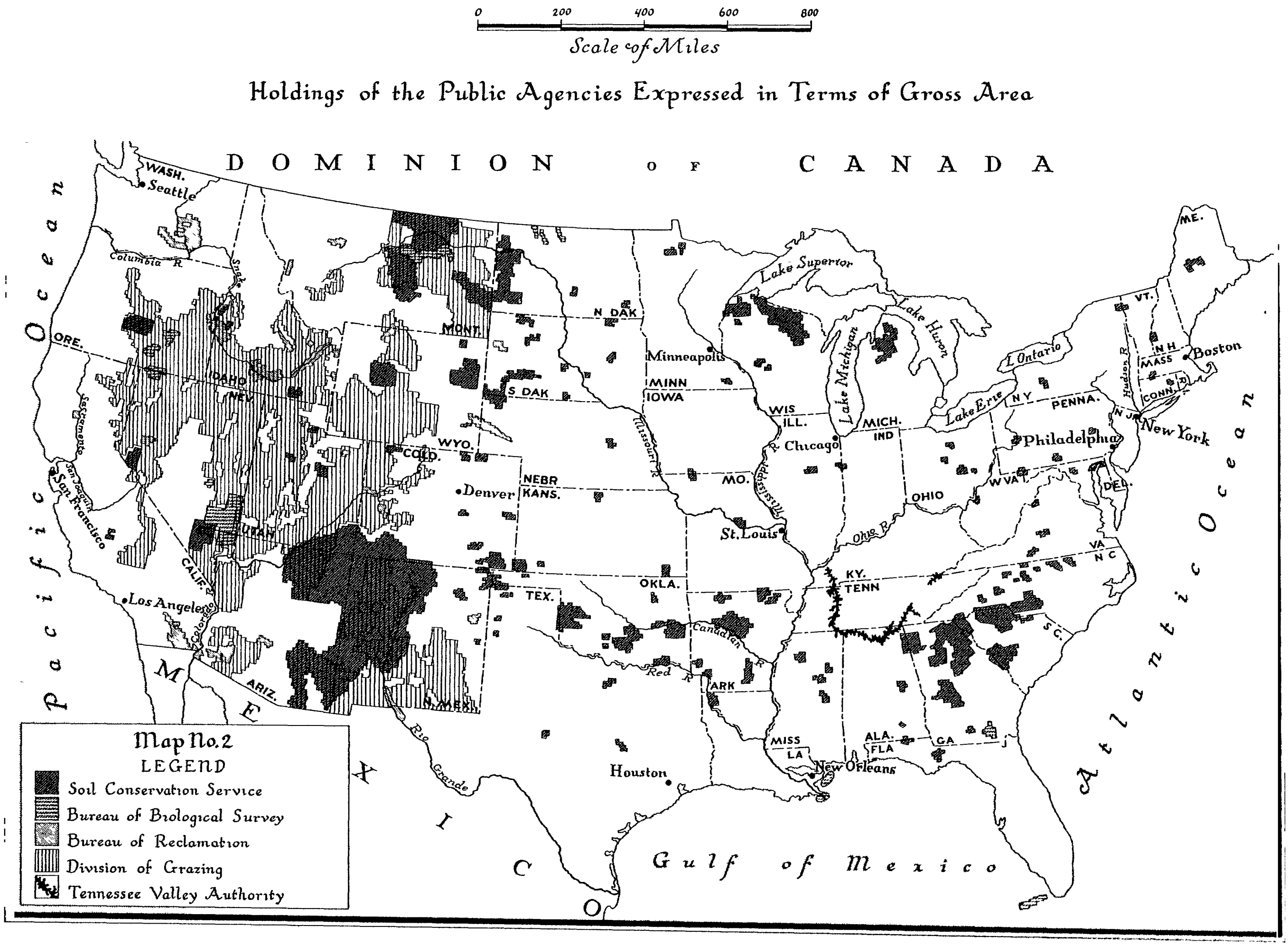
Water resource conservation embraces control, development, and utilization of water for a wide variety of objectives. It includes promotion of navigation, protection against floods, irrigation, power development, drainage, control of soil erosion and siltation, pollution abatement, maintenance of domestic and industrial water supplies, recreation, and fish and game protection. Federal, state, and local governments have been concerned with one or another phase of water conservation since the beginning of our national history. Canals were a leading element in the various internal improvement programs of the early nineteenth century. The New England states took measures shortly after the Civil War to protect fish life in their streams from industrial pollution. As metropolitan centers grew in size, water supply became a leading function of local government. In the arid regions of the West, state courts and legislatures developed a highly elaborated water law governing individual rights to the appropriation of this all-important substance. Since the turn of the twentieth century, irrigation, power, and flood control have come within the range of federal policy. Only in recent years, however, have steps been taken to convert a series of water conservation policies into a unified policy taking into account all the interrelated purposes of water control, in keeping with the objective physical unity of the natural river systems.



The Major Land Use Projects of Public Agencies

Based on a Department of Agriculture Map Issued in 1939

Holdings of the Public Agencies Expressed in Terms of Gross Area



From the very start, a prominent role was played in water conservation activities by the federal government. The interstate character of almost all the great drainage basin systems, and the importance of rivers as channels of inland transportation, clearly made their control a matter of more than state concern. Federal jurisdiction in this area depended, for the most part, upon the interstate commerce clause of the Constitution. The broad scope of this clause was recently emphatically asserted by the Supreme Court, in the declaration that "navigability . . . is but a part of this whole. Flood protection, watershed development, recovery of the cost of improvements through utilization of power are likewise parts of commerce control." [12] Legal authority for the federal water conservation program has also been found in the power to spend in pursuance of the general welfare and in control over the public lands.

River development for purposes of navigation must be viewed primarily as an aspect of promotional transportation policy rather than as an element in water conservation. The history of such development has been broadly sketched in Chapter 4. It is important to note, however, that navigation may be a significant element of the multiple-purpose type of water development which has become the characteristic hallmark of twentieth-century water policy.

For communities located on the banks of major rivers, protection against floods has always been a principal concern of local government. Construction of levees and flood walls was until recent decades almost the sole means of protection. When serious floods brought disaster to particular areas, the federal government intervened to provide temporary relief, but withdrew its assistance as the flood waters subsided. Minor contributions, particularly in the form of plans and surveys, were made to a solution of the problem by the Mississippi Valley Commission established by Congress in 1879. Moderate financial support was also given to Mississippi flood control in 1917 and 1923. With the catastrophic lower Mississippi flood of 1926, however, the balance of government responsibility for flood control was radically altered. While affirming the desirability in principle of a division of financial contributions between local and national governments, Congress declared that in view of the estimated $292,000,000 spent before 1928 by local interests in the Mississippi Valley for flood protection and

[12] *United States* v. *Appalachian Electric Power Company*, 61 S. Ct. 291 (1940).

in view of the extent of national concern in the control of these floods in the interests of national prosperity, the flow of interstate commerce, and the movement of the United States mails; and in view of the gigantic scale of the project, involving flood waters of a volume and flowing from a drainage area largely outside the states most affected and far exceeding those of many other rivers in the United States, no local contribution to the project adopted is herein required.[13]

Extension throughout the nation of the principle of federal support for flood control was adopted by the comprehensive Flood Control Act of 1936. Local authorities were still to provide the cost of land, easements, and rights of way, but the bulk of the financial burden was now placed on the federal treasury. Two years later the requirement for local contributions was even further reduced. Thus, flood protection became a matter predominantly of national concern and an important element in the large-scale federal public works programs of recent years. In 1940, approximately $170,000,000 were spent on flood control projects. Meanwhile, technical progress in flood protection techniques had demonstrated that effective control could generally best be provided by dams and reservoirs on the tributaries of major streams. The application of this technique, in addition to the older devices of levees, flood walls, and floodways, made it possible to promote other objectives of water conservation conjointly with flood control.

The third major aspect of water resource conservation is irrigation. In the seventeen states lying wholly or partially to the west of the one-hundredth meridian, except in limited areas, successful farming is virtually impossible without an artificial water supply to supplement the limited rainfall. Even grazing often requires supplemental water for stock subsistence. Large-scale irrigation was first undertaken before the Civil War through co-operative action by local colonies of settlers; the Mormon Project near the Great Salt Lake was the outstanding example. Toward the end of the nineteenth century land and railroad companies, desirous of rapid settlement on their holdings, promoted an irrigation boom on a considerable scale. The possibility of federal assistance to irrigation was seriously canvassed immediately before the turn of the century. Under the leadership of Theodore Roosevelt, promotion of irrigation became a national policy through enactment of the Reclamation Act of 1902.

[13] Mississippi Valley Flood Control Act of 1928, 45 Stat. 535, Sec. 2.

The Act of 1902 established a reclamation fund, into which proceeds of public land sales in the Western states were to be deposited. The fund was to be employed for irrigation projects, the cost of which would be gradually repaid, without interest, by the water users. Repayments would flow into the fund and be available for further projects. A share of the yield of oil and mineral royalties from the public lands, and of license fees for water-power sites, has subsequently been added to the fund. Since 1906, power development has been carried on in conjunction with reclamation projects wherever possible, in order to provide a share of the total cost.

It is estimated that approximately 40,000,000 acres in all might be irrigated through full use of available water in the Western states; of this area, somewhat over 30,000,000 acres now receive artificial water supplies. About 3,700,000 acres are supplied through federal projects. The total investment amounts to some $600,000,000, of which roughly half will ultimately be repaid.[14] Government operations vary in size from garden patches on Indian reservations to the spectacular Boulder, Grand Coulee, Central Valley, and Colorado–Big Thompson projects. A few projects have been abandoned and repayments on several others have not been maintained in spite of successive moratoria and extensions of payment periods. On the whole, however, the principles of the Act of 1902 have been maintained intact. A major amendatory statute, the Reclamation Project Act of 1939, was designed to safeguard the principle of repayment by systematic variation of annual charges with water users' income. It also served to clarify the principles governing the adoption of new projects.

Federal irrigation policy has often been challenged during its four decades of operation, largely by Easterners who look upon it as an unwarranted sectional subsidy. In the West, however, it is viewed as an essential prerequisite of agricultural and community stability in large areas. Its beneficiaries emphasize the contrast between the repayment features of irrigation policy and the wholly unreimbursed federal contributions to river and harbor development and flood control. The criticism that reclamation opens up new farm land, at a time when general agricultural policy favors land retirement, is answered in terms of the local consumption of most irrigation products and their complementary rather than competitive relation to the general agricultural economy. Some of the

[14] No repayments are made on Indian reclamation projects.

most outstanding projects, moreover, supply supplemental water essential to the continuance of pre-existing highly intensified cultivation, and do not result in the creation of new farming areas. Other projects, like Boulder, are considered justified as much by their associated functions, such as domestic water supply, flood control, and power, as by their use for irrigation. In the case of the greatest project of all, that at Grand Coulee, the opening of new farm lands and the development of extremely low-cost power are intended to provide stable agricultural and industrial communities affording permanent economic opportunities to populations now dependent upon declining lumbering or mining occupations. Plans are being carefully devised for gradual settlement of the project lands over a twenty-year period.

In consequence of the severe droughts of 1934 and 1936, and of increasing recognition of the interrelation of water supply, water control, and soil conservation, particularly in the Great Plains area, irrigation policy has recently been extended along two significant lines. The Pope-Jones Water Facilities Act of 1937 authorized the Agriculture Department to promote the construction and maintenance of small ponds, reservoirs, wells, checkdams, pumping installations, and similar works. The Wheeler-Case Act of 1939, somewhat broadened in 1940, provided for water conservation and utilization projects in areas where local economic conditions made it impossible for farmers to provide repayment in accordance with the principles of the general reclamation law. Through the use of relief labor, the Civilian Conservation Corps, and contributions from the Agriculture Department, repayable charges on such projects were reduced to accord with the financial capacity of the water users. The program was designed to contribute to the stabilization of agricultural operations in one of the most distressed sections of the nation.

In recent decades electric power development has played a steadily increasing role in the totality of water-control activities. The rapid expansion of public power operations under the Roosevelt Administration has been described in Chapter 10. As a source of revenue, power development makes an important and often decisive contribution to the economic feasibility of many water conservation projects. Without the aid of power sales, flood protection for the Imperial Valley of California through the Boulder Dam, essential supplemental water supplies for irrigation in the Central

Valley of California, and the opening up of over one million acres to productive use in the Grand Coulee region in Washington would probably all have been impossible. The National Resources Committee has recently summarized the relation of power development to water conservation in the following terms:

> Almost any considerable project for the control or use of any important stream will serve—or can serve—more than one useful purpose. There need be no conflict between the several purposes, including power, if the full possibilities of the stream are realized in the public interest. The objective is to develop each of the resources of a major stream in harmony with the others, to the end that the sum of the potential benefits to the public shall be a maximum. . . .
>
> An active public policy of multiple-purpose development of water resources is desirable, in view of the pressing character of problems related to flood control, public water supply, stream pollution, irrigation, and navigation, and in view of positive reasons for public development of water power. An active policy of public development of water power is likewise desirable. Both development directly for power purposes, where there is no conflict with more urgent water control, and the best feasible use of head made available by storage for other purposes would contribute toward the attainment of three major national objectives, namely: (a) conservation of scarce fuel materials—petroleum, natural gas, and high-grade coals; (b) strengthening the national economy, through bringing about cheaper electricity more widely available; (c) strengthening the national defense through better assurance of ample electrical energy in time of war.[15]

With the intervention of government into successive areas of water conservation there has developed a growing recognition of the close interrelation of water problems and of the consequent need for co-ordinated planning in order to realize the maximum potentialities inherent in the great river systems. Theodore Roosevelt's Inland Waterways Commission laid a foundation in 1907 for this type of comprehensive approach to water conservation. Partial co-ordination has been provided by subsequent water legislation in a number of respects. Thus, the Army Engineers are required to obtain the advice of the Federal Power Commission on power potentialities in the design of flood control projects, and to cooperate with the Department of Agriculture in measures for runoff

[15] National Resources Committee, *Energy Resources and National Policy,* 1939, pp. 25, 27.

retardation and soil erosion prevention on watersheds above navigation or flood control works. Again, under the Reclamation Project Act of 1939, the Interior Department must consider power development, municipal water supply, and other allied purposes in the planning of any new irrigation project. The Tennessee Valley Authority is charged with comprehensive planning for water control in all its aspects in the Tennessee River basin. Substantial impetus has been given to co-ordinated water planning by the National Resources Committee, through a nation-wide series of drainage basin committees established to aid in the development of integrated plans for control works on each major river system. Despite substantial progress in this direction, however, the establishment of a unified national water policy remains for the future.

3. Conservation and Planning

Modern conservation policy is a compound of many separate policies dealing with particular aspects of individual natural resources. These separate policies stem from a great variety of needs, interests, and pressures. In some areas, such as forestry, they arose from genuine concern over rapid depletion of major national assets. In others, such as water transportation and irrigation, they were phases of a general promotional program. Sometimes conservational considerations were subordinate to political pressures for widespread local distribution of federal funds; thus, river and harbor development was viewed for many decades as the typical "pork barrel." At other times, policy was extended into new fields in response to dramatic catastrophes resulting from lack of control, such as the disastrous floods of 1927, 1935, and 1936, or the dust storms of 1934. Conservation has often been an incidental by-product of more pressing short-term needs.

Whatever the origin of such particular policies, the interlocking relationships among the various natural resources tended to produce a pattern of general conservation policy. The development was gradual but the trend was clear. It has been reflected in recent years by the creation of a host of government planning agencies devoted primarily to natural resources control and utilization.

The planning concept in relation to natural resources does not involve general economic regimentation in the manner of the totalitarian nations. It is concerned with the physical framework within

which the economy operates rather than with day-to-day economic operations. Its emphasis is upon co-ordination of policies and administration and harmonization of immediate objectives with longer run considerations. Planning in this limited sense is particularly appropriate to conservation policy for two reasons. The range of activity is so broad as to involve, of necessity, a multitude of administrative agencies, national, state, and local; yet the operations of such agencies impinge so closely upon one another as to demand co-ordination in order to achieve optimum results, and even in order to avoid nullification of isolated efforts. At the same time, conservation policy by its very nature attempts to strike a balance between present and future. It consequently requires systematic estimation of future needs as a basis for policy making in terms of long-run programs. In many of its phases, notably forestry and soil conservation, the fruits of government action can be harvested only over a period of many decades.

"Planning," in greater or less degree, has always accompanied conservational activities. An identifiable planning movement, however, is a product of the twentieth century. It arose in the first instance in the realm of urban local government, where the socially undesirable consequences of uncontrolled land use were particularly evident. The modern planning profession is still centered largely about the function of city planning. On a larger scale, New York, New Jersey, and Wisconsin established state-wide planning agencies during the nineteen-twenties, while the desirability of national planning for natural resources conservation was expressed by the short-lived National Conservation Commission of 1908.

The New Deal, with its enormous public works program, brought the public planning movement to an unprecedented level of activity. A National Planning Board was established in 1933 in the Federal Emergency Administration of Public Works, to assist the Administrator through (1) preparation of comprehensive regional public works plans, (2) surveys of population distribution and trends; land use; industrial, housing, and natural resources; and general social and economic trends, and (3) project analysis to ensure co-ordination in location and sequence. Late in 1933 the Public Works Administrator circularized the state Governors with regard to the desirability of state planning boards. Within a year favorable responses were obtained from forty-two states, and by 1937 all the states but two had established one or another form of official plan-

ning agency. On the federal scene, the National Planning Board was succeeded, in turn, by the National Resources Board (1934–35), the National Resources Committee (1935–39), and the National Resources Planning Board (1939–), which was placed in the Executive Office of the President. In the executive order establishing the last-named agency, the President described its functions as follows:

(a) To survey, collect data on, and analyze problems pertaining to national resources, both natural and human, and to recommend to the President and the Congress long-time plans and programs for the wise use and fullest development of such resources.

(b) To consult with federal, regional, state, local, and private agencies in developing orderly programs of public works and to list for the President and the Congress all proposed public works in the order of their relative importance with respect to (1) the greatest good to the greatest number of people, (2) the emergency necessities of the nation, and (3) the social, economic, and cultural advancement of the people of the United States.

(c) To inform the President of the general trend of economic conditions and to recommend measures leading to their improvement or stabilization.

(d) To act as a clearing house and means of co-ordination for planning activities, linking together various levels and fields of planning.[16]

The years since 1938 have witnessed a mild reaction against the planning movement. The very word "planning," which ranked high in popular esteem in the early thirties, appears to have lost some of its charm. A half-dozen states, in pursuance of economy drives or under new and less sympathetic political regimes, have abolished their planning boards. Even the national agency narrowly escaped severe curtailment of its appropriation in 1940. Despite the temporary setback to planning authorities, however, their approach and methods in natural resources conservation appear to be accepted elements of the broadened responsibilities of modern government.

The conservation of natural resources is significant only in its relation to human needs. The tendency of some enthusiasts, in the first flush of the conservation movement, to view the preservation of natural resources as an end in itself has given way to a more sober appraisal in terms of human use, present and future. The

[16] Executive Order No. 8248, September 9, 1939.

recent planning agencies of the federal government, significantly, have been called "national" rather than "natural" resources boards. In its widest implications, conservation policy is derived from one of the fundamental drives determining the functions of government in the modern economy—the search for stable conditions of individual opportunity and security.

Chapter Twenty-One. CONSERVATION OF HUMAN RESOURCES

1. The Rise of the Service State

In 1850, when Herbert Spencer published his *Social Statics* and proclaimed that "the poverty of the incapable, the distresses that come upon the imprudent, the starvation of the idle, and those shoulderings aside of the weak by the strong, which leave so many 'in shallows and in miseries,' are the decrees of a large far-seeing benevolence," many worthy people of the day were prepared to applaud. Though they might seek to alleviate misery by private charity, they shared his aversion to any assumption by government "of the office of Reliever-general to the poor." The dominant laissez-faire philosophy consigned government to a limited role—that of maintaining order, enforcing contracts, and protecting property. As for the rest, each individual was expected to make his most effective contribution to the common interest by pursuing his own self-interest.

Even at the height of its popularity this theory was not altogether successful in impressing its stamp on public policy. The Industrial Revolution in England was accompanied by a gradual, if haphazard and intermittent, growth of government services to alleviate misery and raise national well-being. Instrumentalities of government were invoked to protect the worker in mines, factories, and workshops—to establish minimum standards of sanitation and hygiene, to provide community services such as public education and housing, and to give some measure of social security to the sick, the elderly, the widowed, the orphaned, and the unemployed. This same pattern of development was recorded in the history of most industrial countries of the world.

In the United States this pattern was slower to unfold. Public education was early recognized as a state responsibility and progress in this field was rapid. While other welfare activities expanded much less rapidly, the long-term trend was always in the direction of a broadening of public obligations. Public hospitals were constructed in large numbers and public institutions were established to care for the aged, the insane, and other special groups of needy persons. Local and state governments assumed an increasing share of the burden of providing poor relief.

Prior to the Great Depression, however, these developments were gradual and intermittent. Whether justified or not, the assumption was widespread that the wealth of the United States provided security for all without the necessity for large-scale government intervention. This assumption was rudely jolted by the prolonged depression which began in 1929. The insecurities generated by the depression produced widespread demands that government provide the security which the private sector of the economy was apparently unable to make available.

During the thirties, first local and state governments, and then later the federal government, assumed an unparalleled burden of new service responsibilities. Government entered the field of slum clearance housing.[1] There was a tremendous growth of expenditures on relief, work relief, and public works. Steps were taken to build a permanent social security program around unemployment compensation and old age insurance as a central core. New interest was awakened in the conservation of human resources. The police state began to give way to the service or welfare state and government was faced with the challenge of making systematic efforts to provide social security for large numbers of insistent citizens. A review of developments in the field of relief and social security will give some measure of the dimensions of this transformation.

2. Public Relief Before the New Deal

Prior to the depression of 1929, relief of the poor and the needy was regarded as primarily a local responsibility, to be borne by private philanthropy or the community in which the dependent person resided. The Elizabethan system of local poor relief which had been transplanted from England to the Colonies continued to provide the

[1] See above, pp. 728–730.

organizational framework for the administration of public relief until well into the twentieth century. Poverty was regarded as a sign of shiftlessness; in order to discourage pauperism the amount of relief granted was meager, and every effort was made to render its reception as unattractive as possible. Before the nineteenth century the problem of pauper care was dealt with through various methods. These included "outdoor" relief, that is, relief to the needy in their own homes; "farming out" or "contracting," by which the lowest bidder undertook to care for a single pauper or all the paupers in a given locality; care in an almshouse; and indenture, or "binding out," a form of apprenticeship which was particularly applicable to children.

During the nineteenth century "outdoor" relief was granted more sparingly; it was regarded as too costly and as encouraging idleness. The tendency was to turn more and more toward the almshouse or "poor farm" as the basic way of providing for the poor. Almshouses became dumping grounds for persons of every age and with every kind of handicap or disability. Frequently the almshouse was turned into a workhouse on the theory that compulsory labor would improve the character of the poor and also make them less costly to the community. Each community sought to limit its load of poor relief by "settlement" laws which confined relief to residents of the locality; the "unsettled poor" could receive no relief and they were frequently expedited on their way to neighboring jurisdictions.

State responsibility for poor relief was slow to develop. A few states made provisions for the so-called "unsettled poor" early in their history. Emergency appropriations for droughts, floods, and other disasters were occasionally made to meet specific needs, but these were sporadic responsibilities. After the Civil War various states began to provide relief for needy veterans. During the nineteenth century there was also considerable development of so-called categorical relief, that is, aid to special classes or categories of needy persons. State institutions were established to take care of the insane, the deaf and dumb, the blind, the feeble-minded, the crippled, and juvenile delinquents. The merely poor were left to subsist on local relief. With the growth of state institutions, the need of supervision led to the creation of State Boards of Charities. The first state to take this action was Massachusetts in 1863. But state supervision of local relief developed haltingly; in 1913, twenty-seven states supervised almshouses only; the rest exercised no supervision over any form of local relief.

The extension of state assistance to persons outside of institutions was a twentieth-century development. Again, it took the form of categorical assistance—aid to the blind, mothers' aid, and old age pensions. In 1907, Wisconsin passed the first state law for aid to the blind in their own homes; in 1911, Illinois and Missouri pioneered with a mothers' aid law; in 1925, Montana and Nevada enacted old age pension laws.[2] Other states followed, but funds made available were small and only a fraction of those in need of assistance was reached. The expansion of these types of categorical assistance had to await the enactment of the Social Security Act of 1935.

Meanwhile, federal activity in the social welfare field developed even more slowly. Aside from emergency appropriations to meet catastrophes and the provision of pensions and care for veterans, perhaps the first important step was the establishment of the Children's Bureau in the Department of Commerce and Labor in 1912 "to investigate and report . . . upon all matters pertaining to the welfare of children and child life among all classes of our people." The Children's Bureau from the beginning devoted its efforts to assisting in the enactment and administration of Mothers' Aid laws and other legislation for child care and protection in the states. It was also vested with the responsibility of administering federal grants-in-aid for maternity and infant hygiene under the Sheppard-Towner Act of 1921. This activity, however, lapsed in 1929 when Congress failed to continue necessary appropriations.

Prevailing doctrine was hostile to the expansion of public relief activities. Public relief was denounced as lending itself to political corruption and as creating an obligation of state support which it was desirable to avoid. It was widely felt that it was preferable to rely on the established private charity societies, and many leaders in social work joined in the protest against "socializing" relief. Yet despite these protests, and despite current popular assumptions to the contrary, the trend toward public relief was already clearly apparent in the two decades before 1929.[3] In 1928, 71.6 per cent of all relief granted in fifteen important cities came from public funds.[4]

[2] The Arizona old age assistance law of 1915 was declared unconstitutional. *Board of Control of the State of Arizona* v. *Buckstegge,* 18 Ariz. 277, 158 Pac. 837 (1916).

[3] See Anne E. Geddes, *Trend in Relief Expenditures, 1910–1935.* Division of Social Research, Works Progress Administration.

[4] Josephine C. Brown, *Public Relief 1929–1939* (1940), p. 55.

THE EFFECT OF THE GREAT DEPRESSION

The depression of 1929 inaugurated a remarkable change of attitude toward public relief. As unemployment increased from four million in January, 1930, to eight million in the spring of 1931, and then to thirteen to fifteen million in the winter of 1932–33, the very magnitude of the catastrophe dispelled the notion that the victims were in any personal sense responsible for their plight. Mounting need forced increasing resort to government to provide relief.

At first, private charity agencies made an effort to carry the increased load. But they were swamped by applications for aid, and the funds which they had available or could raise did not begin to meet the demands which were made upon them. By the summer of 1931 the private agencies were calling for public relief. "The present emergency," said C. M. Bookman, director of the Cincinnati Community Chest, "has reached the point when all of us should see with clearness that it takes the combined resources of government, business, private philanthropy and all other social forces to cope even inadequately with the present calamity." [5]

In October, 1930, President Hoover appointed Colonel Arthur Woods to head the President's Emergency Committee for Employment. The committee took the position that relief needs should be met locally, as far as possible through private agencies. It called upon industry to "spread the work" and "give a job." Meanwhile, unemployment continued to mount and many local governmental units were forced to make heavy appropriations to meet the relief burdens which were thrust upon them. Faced with a severe drain on their treasuries and with declining revenues, many communities called increasingly for state and federal aid.

In 1931 state governments began to act. New York appropriated $20,000,000 in September and an additional $20,000,000 the next March. A Temporary Emergency Relief Administration was set up to administer state aid to the localities. New Jersey, Pennsylvania, and other industrial states took action almost simultaneously and during 1932 and 1933 many more states followed.[6] As local funds were exhausted, the pressure to invoke the broader borrowing and taxing powers of the states became difficult to resist.

[5] *Ibid.*, p. 79.

[6] When the Federal Emergency Relief Act was passed in May, 1933, twenty-two states had appropriated funds for unemployment relief.

The demand for federal relief, meanwhile, also became more insistent. During the winter of 1930–31 some federal emergency relief was made available in drought-affected areas and an effort was made to accelerate federal public works. President Hoover insisted that relief was primarily a local responsibility. In August, 1931, a new committee, the President's Organization on Unemployment Relief, was launched with Walter S. Gifford as director. This committee, like its predecessor, concentrated its energies on encouraging local action. But local effort revealed itself as increasingly inadequate, and the pressure for federal intervention was intensified. In the winter of 1931 bills were introduced in Congress by Senators Costigan and La Follette to provide grants to the states, but nothing came of these proposals. In February, 1932, as the crisis worsened, Congress authorized the Farm Board's Grain and Cotton Stabilization Corporations to distribute government-owned wheat and cotton to the needy through the Red Cross. In July, 1932, the Emergency Relief and Construction Act was passed. It provided for both public works and relief. A total of $300,000,000 was appropriated for federal public works, and the Reconstruction Finance Corporation was authorized to loan up to $1,500,000,000 to states, counties, cities, and in some instances private corporations, for revenue-producing or self-liquidating projects. As a result of the self-liquidating requirements, and the high interest rates charged, relatively few loans were made. At the same time, the Act also authorized the RFC to make $300,000,000 available to states and local governments for relief purposes. This money was to be distributed either to cities and counties in the form of loans, or to the states in the form of advances which were to be deducted from future grants-in-aid for highway construction. The bulk of the money was advanced under the second procedure, but again because of the conditions attached to RFC aid, both state and local governments were slow to act. Hoover was still reluctant to recognize any federal responsibility to provide subsidies for the relief of unemployment. The hopes of the Administration remained fastened on a "natural" business recovery which failed to develop.

3. The New Deal and the Conservation of Human Resources

Under the New Deal a different conception of the role of government emerged. "If, as our Constitution tells us," said President

Roosevelt, "our federal government was established among other things 'to promote the general welfare,' it is our plain duty to provide for that security upon which welfare depends." [7] The federal government took leadership in a many-sided attack on the problem of welfare. Up to 1935, emergency conceptions prevailed. The chief reliance of the federal government was on direct relief, supplemented by a public works program. After 1935 the federal government attempted to stabilize its responsibilities on a different basis. It undertook to provide work for a large portion of the able-bodied unemployed, to supply grants-in-aid to the states to assist them in caring for the aged, the blind, and dependent children, but otherwise to limit its activities in the field of direct relief as far as possible. The residual groups in need of relief, particularly the so-called "unemployables," were to become the primary responsibility of local and state governments. At the same time, through the Social Security Act and related legislation, measures were taken to provide old age insurance and unemployment compensation and to deal with the problem of security on a more permanent basis.

RELIEF AND PUBLIC WORKS, 1933 TO 1935

One of the first acts of the New Deal in the field of relief and public works was the establishment of the Civilian Conservation Corps.[8] An initial allotment of $300,000,000 was made to establish work camps for several hundred thousand unemployed youths between the ages of eighteen and twenty-five, from relief families. Work consisted largely of forest protection, park developments, and soil conservation projects. The federal government undertook to provide subsistence and $30 a month to each enrollee. Of this amount, $25 had to be remitted to the family of the enrollee. The plan won widespread popular approval and was later enlarged.

In May, 1933, Congress enacted the Federal Emergency Relief Act making $500,000,000 available for direct relief. Half of this sum was to be distributed to the states on a matching basis of $1.00 in federal funds for each $3.00 of public relief expended in the states. The other half was to be used in making outright grants to those states whose needs were so great and whose funds so exhausted that the matching provisions of the Act could not be met. While the main emphasis of this program was on federal-state co-

[7] Message to Congress, June 8, 1934, *ibid.*, p. 147.

[8] Put into operation by Executive Order, April 5, 1933.

operation, the President was empowered to authorize the Federal Emergency Relief Administration to assume control of expenditure of federal funds in the states where circumstances justified. This was later done in six states where efforts to secure reasonable relief standards through co-operative action failed.[9]

In June, 1933, the Public Works Administration was established under title II of the NIRA and $3,300,000,000 was appropriated to carry on its work. Through a rapid expansion of public works, the Administration hoped to stimulate a great increase in direct and indirect employment and to release purchasing power to "prime the pump" of private enterprise.[10] The Act provided for three types of projects: (1) Those undertaken directly by agencies of the federal government. (2) Those undertaken by state and local or other non-federal bodies, which were to be financed by 30 per cent grants and 70 per cent loans.[11] (3) Those undertaken by the railroads, which were to be financed by loans. The public works program, however, moved with unexpected slowness. Absence of advance planning and legal and economic barriers encountered by the states and localities in putting their plans into execution tended to delay action, and by the fall of the year the program was still largely in its preparatory stages.

As a result, the Civil Works Administration was hurriedly improvised in November to provide quick employment in the form of work relief. Unlike both P.W.A. and F.E.R.A., the Civil Works Administration was a wholly federal enterprise. Work projects were chosen primarily with a view to speedy increase in employment. Expenditures on material were held to a minimum. Half of the workers were taken from relief rolls; the other half were simply unemployed persons who needed jobs. Wages were paid at "standard rates" and the work week was limited to thirty hours. The sum of $400,000,000 was initially allotted from the $3,300,000,000 public works fund; in February, 1934, an additional appropriation of $950,000,000 was made to carry the program through the winter. At the height of the program in January, 1934, over 4,000,000 workers were employed. As mounting expenditures exhausted available

[9] *Ibid.*, p. 209.

[10] For discussion of the theory of "pump-priming" and the use of public works as an instrument of cyclical control, see J. M. Clark, *Economics of Planning Public Works* (1935) and A. D. Gayer, *Public Works in Prosperity and Depression* (1935).

[11] Maximum grants were later increased to 45 per cent.

funds and criticism of the C.W.A. projects increased, the program rapidly tapered off, and by April, 1934, it was practically terminated.

After the liquidation of C.W.A., readjustments became necessary. P.W.A. reached its peak of approximately 600,000 employed persons in July and August, 1934, and absorbed some of the unemployed, but not on a scale commensurate with existing need. As a result, the main burden fell on F.E.R.A. The relief program returned to a "means test" basis, by which aid was made available only after the personal resources of the relief client had been exhausted. Some effort was made to carry on unfinished C.W.A. projects through an Emergency Works Program which was set up in urban centers. This program was open only to men whose families were on the relief rolls, and payments under the program were adjusted to the family's budgeted needs as computed by local relief authorities. Under this program an average of two million persons was kept at work during the next year. A rural rehabilitation program was also undertaken, though on a much less ambitious scale. Direct relief to persons not employed on works projects was continued, though during 1934 the F.E.R.A. already showed some disposition to cut off funds for so-called "unemployables" and to force them back to local welfare rolls.

On January 4, 1935, President Roosevelt outlined a new relief program in his annual message to Congress. He proposed that the approximately five million families and single people then on emergency relief rolls be separated into two categories—the "unemployables," who for one reason or another would be dependent even in normal times, and the "employables," who could work were there work available. He suggested that the one and a half million "unemployables" become the primary responsibility of the local communities with special assistance for certain categories to be made available through federal grants-in-aid to the states, while the three and a half million "employables" be given useful work under federal auspices. The Emergency Relief Appropriation Act of 1935 followed the President's suggestion and appropriated $4,800,000,000 for public works and work relief. Of this total, approximately a billion dollars was spent in liquidating the F.E.R.A. program and $1,400,000,000 was assigned to a newly created Works Progress Administration to provide work for "employables." The remainder was allocated to P.W.A. and other purposes.

W.P.A. AND ITS RELATION TO RELIEF

Beginning in the fall of 1935, W.P.A. took over the major burden of providing work relief. Unemployed workers absorbed by the W.P.A. were certified as in need of relief, but, in contrast with the F.E.R.A. work relief program, they were paid a "security wage" instead of sums based on case-work investigation of family needs. This "security wage" varied with skill and locality and ranged from $19 to $94 a month. In the 1939 Relief Act sectional wage differences were minimized by a stipulation that they be no greater than differences in living costs. Under the new schedule of payments, wages varied from $31.20 to $94.90 per month.

At first hourly wages were below prevailing wages in the locality, but in 1935, as a result of vigorous protests from organized labor, the principle of prevailing wages was adopted and hours of work were reduced to bring the hourly wage up to the prevailing rate. In 1939, however, this principle was reversed and a work month of 130 hours was prescribed for all W.P.A. projects employees. Projects varied with the skills available and were chosen with an eye to minimum expenditures on materials. Highway, road, and street work and construction projects engaged many unskilled workers. Large numbers of women were assigned to sewing projects. Special educational, professional, and recreational projects were provided for white-collar workers. In 1935 the National Youth Administration was established as a unit within the Works Progress Administration in order to provide part-time work and training for needy youths who had been unable to find employment and also to provide part-time work to assist needy young people to continue their education at schools, colleges, and universities.

Employment on W.P.A. projects reached an initial peak of slightly over three million at the end of February, 1936, and then began to taper off. With the improvement of business during 1936 and the first half of 1937, Congressional appropriations for relief and public works were sharply curtailed and W.P.A. employment declined to 1,454,000 in September, 1937. Following the business recession which began in October, 1937, expenditures for work relief and public works again expanded. In June, 1938, Congress authorized a new public works program. The life of the Public Works Administration was extended to June 30, 1941, and $965,000,000 was

TABLE I

SCHEDULE OF MONTHLY EARNINGS ON W.P.A. PROJECTS [12]

EFFECTIVE SEPTEMBER 1, 1939

Counties in which the 1930 population of the largest municipality was—	*Wage class*				
	Unskilled "B"	*Unskilled "A"*	*Intermediate*	*Skilled*	*Professional and technical*
Wage region I					
100,000 or more [a]	$52.00	$57.20	$68.90	$89.70	$94.90
25,000 to 100,000	48.10	52.00	62.40	81.90	84.50
5,000 to 25,000	42.90	48.10	57.20	74.10	76.70
Fewer than 5,000	39.00	42.90	52.00	67.60	68.90
Wage region II					
100,000 or more [a]	52.00	57.20	68.90	89.70	94.90
25,000 to 100,000	48.10	52.00	62.40	81.90	84.50
5,000 to 25,000	46.80	50.70	61.10	79.30	81.90
Fewer than 5,000	44.20	49.40	59.80	76.70	78.00
Wage region III					
100,000 or more [a]	46.80	50.70	61.10	79.30	81.90
25,000 to 100,000	42.90	48.10	57.20	74.10	75.40
5,000 to 25,000	36.40	40.30	48.10	62.40	65.00
Fewer than 5,000	31.20	35.10	42.90	54.60	55.90

Wage region I. Connecticut, Delaware, District of Columbia, Illinois, Indiana, Iowa, Kansas, Maine, Maryland, Massachusetts, Michigan, Minnesota, Missouri, Nebraska, New Hampshire, New Jersey, New

[a] The schedule of monthly earnings applicable to counties in which the 1930 population of the largest municipality was 100,000 or more is applicable to the entire area included within the following metropolitan districts, as such districts are defined by the 15th Census of the United States, 1930: Baltimore; Boston; Buffalo-Niagara; Chicago; Cincinnati; Cleveland; Detroit; Kansas City, Kans.–Kansas City, Mo.; Los Angeles; Milwaukee; Minneapolis–St. Paul; New York City–Northeastern New Jersey; Philadelphia; Pittsburgh; Providence–Fall River–New Bedford; St. Louis; San Francisco–Oakland; Scranton–Wilkes-Barre; Washington, D.C.

[12] From *Report of the President of the United States to the Congress Showing the Status of Funds and Operations under the Emergency Relief Appropriation Acts of 1935, 1936, 1937, 1938, and 1939 as of December 31, 1939*, January 15, 1940, p. 27.

York, North Dakota, Ohio, Pennsylvania, Rhode Island, South Dakota, Vermont, West Virginia, Wisconsin.

Wage region II. Arizona, California, Colorado, Idaho, Montana, Nevada, New Mexico, Oregon, Utah, Washington, Wyoming.

Wage region III. Alabama, Arkansas, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, Oklahoma, South Carolina, Tennessee, Texas, Virginia.

made available, of which up to $200,000,000 was to be used for federal projects, and up to $750,000,000 for nonfederal projects on a 45 per cent grant basis. This time advance preparation had been made and the P.W.A. program was executed with dispatch. Meanwhile, W.P.A. appropriations were also increased and by October, 1938, the number of persons employed on W.P.A. financed projects had mounted to 3,346,000, slightly higher than the earlier peak load of February, 1936.

With business improvement during 1939, W.P.A. appropriations for the fiscal year ending June 30, 1940, were reduced to $1,447,000,000. The Emergency Relief Appropriation Act of 1939 imposed a number of restrictions on W.P.A. activity. The Federal Theater was abolished. Federal participation in W.P.A. public building projects was limited to $52,000 per project. Federal funds for nonlabor expenditures were curtailed, and after January 1, 1940, at least 25 per cent of the total cost of all nonfederal projects was required to be borne by the sponsoring state and local agencies. The work month of W.P.A. workers was fixed at 130 hours. With the exception of veterans, all relief workers who had been continuously employed by the W.P.A. for more than eighteen months were ordered dropped from the rolls, though the law provided that they could be recertified as eligible for employment after a thirty-day interval. The latter provision greatly increased labor turnover, seriously interrupted many projects, and resulted in personal hardships in numerous cases. It was defended, however, on the ground that the vacancies created provided places for many needy and eligible persons who previously had been unable to obtain W.P.A. employment. By July, 1940, W.P.A. employment had declined to 1,639,000 and the prospect of further reductions loomed as the defense boom made itself felt. W.P.A. appropriations for the fiscal year 1940–41 were further reduced to $1,157,000,000; numerous items, however, were included for defense purposes, and restrictions imposed by the Act of 1939 were waived on defense projects.

When the W.P.A. program was inaugurated, the hope was that it would provide work for "employables," while responsibility for so-called "unemployables" would largely be passed back to the local communities. In practice, this distinction proved difficult to observe. Because of inadequate appropriations, W.P.A. proved unable to give work to all able-bodied unemployed, and thus many "employables" were forced to apply for local relief. The discontinuance of the F.E.R.A. program of federal support for direct relief at the end of 1935 imposed a heavy burden on local relief authorities. A period of confusion followed. Funds for general relief were inadequate or lacking in many states and localities and considerable suffering ensued. Although general relief appropriations by states and localities later increased and averaged about $450,000,000 a year for the period 1936–39 (approximately the level of state contributions for emergency relief under the F.E.R.A. program), these expenditures were very unevenly distributed among the states, and average monthly benefits showed wide variations in different localities. In December, 1939, for example, the average amount distributed monthly per relief case varied from $2.91 in Mississippi to $36.43 in New York.[13]

Meanwhile, however, not all of the load of direct relief was thrust back on the states and localities. Emergency relief to farmers which was begun under the F.E.R.A. was continued by the Resettlement Administration and its successor organization, the Farm Security Administration of the Department of Agriculture. At the peak of the program early in 1937 approximately 300,000 farmers were receiving relief payments in addition to other assistance in the form of loans. The Federal Surplus Commodities Corporation (now the Surplus Marketing Administration), carried on the work of distributing surplus farm commodities to relief clients through the state and local departments of welfare and, beginning in May, 1939, by means of the Food Stamp Plan.[14] During the fiscal year 1938–39, approximately two billion pounds of surplus farm commodities were distributed to some three million families.

PUBLIC ASSISTANCE PROGRAMS UNDER THE SOCIAL SECURITY ACT

With the enactment of the Social Security Act of 1935, the federal government broadened its obligations to provide public as-

[13] *Social Security Bulletin,* February, 1940.

[14] See above, p. 123.

sistance to defined categories of needy persons. In addition to the provisions for old age insurance and unemployment compensation (which will be discussed separately), the Act provided for federal co-operation in state plans for public assistance to the needy aged, the needy blind, and dependent children, to be administered under the direction of the Social Security Board. The Act also extended federal aid to the states for various health and welfare services and for vocational rehabilitation.[15]

Of the three types of public assistance sponsored by the Social Security Board, aid to the blind has been the least important in terms of monetary outlays. Under the Act of 1935, the Board undertook to meet half the cost of aid made available to the blind under approved state plans up to a federal-state total of $30 per month; in 1939 the total was increased to $40 per month. As of September, 1940, plans for aid to the blind had been approved for forty-one states, the District of Columbia, and Hawaii. A total of 48,278 persons received aid; payments from federal, state, and local funds for the month were $1,124,887 and the average amount paid was $23.30. Payments, however, varied greatly from state to state, ranging from $8.09 in Mississippi to $48.06 in California.[16]

Aid to dependent children has been given on a more extensive scale. Under the Act of 1935, federal grants for this purpose were limited to one third of a federal-state total of $18 for the first child

[15] These services are administered by agencies other than the Social Security Board. The Office of Education makes grants to the states on a matching basis for programs of vocational rehabilitation designed to place physically disabled and handicapped persons on a self-supporting basis. The Public Health Service makes grants on a similar basis to aid in the establishment and maintenance of adequate state and local public health services. The Children's Bureau administers grants to the states for three programs—maternal and child health, services for crippled children, and child welfare services. Additional appropriations to carry on these activities were authorized by Congress in 1939. Authorizations for 1935 and 1939 are listed in the following table:

Program	*1935 provisions*	*1939 provisions*
Vocational Rehabilitation	$1,938,000	$ 3,500,000
Public Health	$8,000,000	$11,000,000
Maternal and Child Health	$3,800,000	$ 5,820,000
Services for Crippled Children	$2,850,000	$ 3,870,000
Child Welfare Services	$1,500,000	$ 1,510,000

[16] *Social Security Bulletin,* November, 1940, p. 68. The states of Illinois, Missouri, Nevada, and Pennsylvania administered assistance to the blind without federal financial participation. In November, 1940, these states paid out $715,000 to 24,500 blind persons.

and of $12 for each additional child in the same family. Under the liberalizing amendments of 1939, the federal contribution was increased to one half and the age limit for a child classed as dependent was raised from sixteen to eighteen years, provided the child was found to be regularly attending achool. As of September, 1940, plans for aid to dependent children had been approved for forty states, the District of Columbia, and Hawaii. A total of 828,654 children received aid and payments for the month amounted to $11,-018,962. The average amount paid per family was $32.11, though again there was a wide range in average payments from $11.38 in Arkansas to $57.77 in Massachusetts.[17]

In terms of expenditures and in numbers of recipients, old age assistance has become the most important form of public assistance administered by the Social Security Board. At the end of 1934, just before the passage of the Social Security Act, twenty-eight states and two territories had statutes providing for old age assistance. "In only ten states, however, was the program state-wide in operation, and in three states the old-age assistance law was entirely inoperative because of lack of funds." [18] The assistance made available was very small, totaling approximately $32,200,000 in 1934, while the organized pressure for special provisions for the aged was increasing in intensity. The Townsend Movement, with its promise of $200 a month for all persons over sixty, attracted an extraordinary amount of support among the old and "near-old," and petitions and letters poured in by the thousands calling upon Congress to adopt the plan.

While the Townsend Plan was passed over, the Social Security Act as finally enacted made two types of provisions for old age—one, a national scheme for compulsory old age insurance, which, however, was not to begin to provide annuities until 1942; and the other, a system of matched grants which was designed to go into effect immediately. Under the latter, the federal contribution was limited to $15 a month per individual. State plans for old age as-

[17] *Social Security Bulletin*, November, 1940, p. 67. "In September, 1940, $340,000 was expended for aid to dependent children in nine states in which such assistance was administered without financial participation by the federal government. This amount was paid to 14,100 families in behalf of 32,500 dependent children in Alaska, Connecticut, Illinois, Iowa, Kentucky, Mississippi, Nevada, South Dakota, and Texas." *Ibid.*, p. 65.

[18] Social Security Board, *Trends in Public Assistance, 1933–1939* (1940), p. 15.

sistance, in order to be approved, had to provide for payment of assistance to persons sixty-five years of age or above and meet other conditions prescribed by the Act. The states were quick to qualify under the law, and by September, 1938, every state and territory eligible for grants was administering old age assistance under plans approved by the Social Security Board.

The rapid expansion of the program was attended by a considerable growth in payments and recipients. Total assistance made available increased from $155,000,000 in 1936 to $430,000,000 in 1939; the number of recipients of aid increased from approximately 430,000 in January, 1936, to 1,776,000 in December, 1939. The differences in state payments were great. Though the average payment for the country as a whole was $19.17 a month in September, 1938, payments ranged from $5.65 a month in Mississippi to $32.65 in California. As a result, many of the poorer states pressed for a guaranteed federal minimum contribution or some system of variable grants which related payments to a state's economic needs or fiscal capacity. At the same time the Townsend Plan was revived and, though voted down in the House by a three to one majority in June, 1939, it was not without effect in stimulating a liberalization of benefits.

The Social Security Act amendments of 1939 raised the federal contribution for old age assistance from $15 to $20 a month, thus making it possible for states to provide pensions of as much as $40 a month by paying half the cost. Proposals to vary grants with need and thus aid the poorer states were defeated. As of September, 1940, the state disparities in old age assistance payments were more marked than earlier, varying from $7.18 in Arkansas to $37.91 in California.[19] Thus far the principal beneficiaries of the 1939 amendments have been the wealthier states, and the dependent aged in the poorer states have continued to receive very inadequate assistance.[20] The Social Security Board has declared its belief

[19] *Social Security Bulletin,* November, 1940, p. 66.

[20] Senator Byrnes, in testifying before the Senate Finance Committee on June 15, 1939, criticized the plan for increasing federal grants on a matched basis as follows:

". . . As to most of the states, the Congress might just as well provide that it will pay $100 per month when that amount is matched with $100 by a state . . . it is absurd to believe that the state that cannot match $15 is going to be able to match $20. . . . The only result will be to make the rich state richer and the poor state poorer." *Hearings, Social Security Amendments,* Senate Committee on Finance, 76th Cong., 1st Sess., 1939, p. 287.

> that it is essential to change the present system of uniform percentage grants to a system whereby the percentage of the total cost in each state met through a federal grant would vary in accordance with the relative economic capacity of the state. There should, however, be a minimum and maximum limitation to the percentage of the total cost in a state which will be met through federal grants.[21]

Proposals to implement these recommendations will undoubtedly be revived, though they are likely to meet strong opposition from the wealthier states which benefit by the existing system.

OLD AGE INSURANCE

In the United States legislation to provide security for old age has lagged behind that of most industrial countries, despite the increasingly serious character of the problem. Recent estimates have indicated that "approximately 65 per cent of all persons aged sixty-five and over are wholly or partially dependent, of whom nearly one third are dependent on public or private social agencies and two thirds on friends and relatives." [22] The number and proportion of aged people have been steadily growing. In 1900 the 3,080,000 persons aged sixty-five and over constituted 4.1 per cent of the population. In 1930 the 6,634,000 persons aged sixty-five and over made up 5.4 per cent of the population. In 1939 persons sixty-five and over numbered 8,180,000, or approximately 6.3 per cent of the population. The National Resources Committee has estimated that by 1980 there will be over 22,000,000 persons aged sixty-five and over, representing 14 to 16 per cent of the population. With the decline in family size and family responsibility for care of the aged and the prospect of an increased proportion of old people in the population, the necessity of a constructive program for old age security has been sharply emphasized.

The Social Security Act of 1935 attempted to deal with the problem by providing federal grants-in-aid to approved state programs for old age assistance and by establishing a national system of old age insurance. The provisions for old age assistance were designed to protect needy persons who were already old or who would become old in the future without the opportunity to benefit by the insurance program. The provisions for old age insurance were in-

[21] Statement of A. J. Altmeyer, Chairman of the Social Security Board, before the Senate Finance Committee, June 12, 1939, *ibid.*, p. 35.

[22] *Final Report of the Advisory Council on Social Security*, December 10, 1938, p. 15.

tended to prevent future old age dependency on the part of persons covered by the program. Through a contributory system which related benefits to contributions, protection was to be made available as a matter of right, without the use of a "means test."

Despite constitutional doubts, Congress placed the old age insurance system on a nationally administered basis.[23] Approximately two thirds of the employed population were covered by the Act. The excluded groups included agricultural labor, domestic servants, casual labor, the self-employed, government employees, railroad employees, and persons employed by religious, charitable, scientific, educational, or other non-profit-making organizations. Provision was made for railroad employees in separate legislation.[24] The exclusion of farm and domestic employees was based, to a considerable extent, on the anticipated administrative difficulties of making the Act applicable to them, though it was widely recognized that these groups greatly needed protection against dependent old age.

In order to finance the system, taxes were imposed on all employers and employees covered by the Act. For the three-year period 1937–1939, employers and employees were each to pay at the rate of 1 per cent on all wages and salaries under $3,000 a year. Under the Act of 1935, these payments were to be increased to 1½ per cent for

[23] In *Helvering* v. *Davis*, 301 U.S. 619 (1937) the Supreme Court by a seven to two majority upheld the constitutionality of the old age insurance provisions of the Social Security Act.

[24] The first Railroad Retirement Act was enacted in 1934 and declared unconstitutional the next year in *Railroad Retirement Board* v. *Alton Railroad Company,* 295 U.S. 330. A second Railroad Retirement Act was passed in 1935 and was, in turn, amended and superseded by the Railroad Retirement Act of 1937. Like the broader old age insurance program, the Railroad Retirement Act provides for taxes on both employers and employees and benefits based on the previous earnings of the worker. Taxes on employers and employees begin at 2¾ per cent each in 1937 and rise ¼ per cent every three years until they reach a maximum of 3¾ per cent each in 1949. The Act provides for payment of old age and survivor annuities, but, unlike the Social Security Act as amended in 1939, it makes no provision for dependents of retired workers. In contrast with the Social Security Act, however, it does provide for payment of benefits for permanent total disability and for the continuation of pensions to individuals who were on the pension rolls of employers at the time of the passage of the Act. Both eligibility requirements and benefit payments are considerably more liberal than those provided by the Social Security Act. "As of December 31, 1938 . . . the average amount of age annuities was $65.33; the average amount of disability annuities $71.34, and the average pension payment $58.25." See Murray W. Latimer (Chairman, Railroad Retirement Board), "The Security Program for Railroad Workers," in *Social Security in the United States* (A Record of the Twelfth National Conference on Social Security) (1939), p. 52.

the years 1940–1942, 2 per cent for the years 1943–1945, 2½ per cent for the years 1946–1948, and 3 per cent for 1949 and beyond.

The structure of benefits provided by the Act represented a compromise between the private insurance principle of adjusting benefit payments to individual contributions and the broader social principle of determining benefit payments on the basis of need. No benefit payments were to be made until 1942. To be eligible for benefits, an individual had to be at least sixty-five years of age, employed in an insured industry at least one day in each of five years after December 31, 1936, and in receipt of at least $2,000 in total wages during that period. The amount of monthly benefits was related to total earnings in accordance with the following formula: ½ of 1 per cent on the first $3,000 received, 1/12 of 1 per cent on the next $42,000, and 1/24 of 1 per cent on all sums received over $45,000. The Act specified a maximum monthly benefit of $85 a month and provided that earnings in excess of $3,000 a year were not to be included in computations of total earnings. The minimum benefit available under this formula was $10 a month, that is, ½ of 1 per cent of $2,000. Benefits, however, were not to be paid to persons continuing at their regular employment beyond sixty-five. For those unable to qualify for monthly annuities, the Act provided a lump sum payment of 3½ per cent of total earnings. Death benefits of 3½ per cent of total earnings were also made available to the estates of persons dying before the age of sixty-five. In the event of death after sixty-five without having received at least 3½ per cent of total earnings, a death benefit was to be paid measured by the difference between such 3½ per cent and payments previously made. Thus, the contributing employee (or his estate) was assured a return in excess of the sum contributed.

The old age insurance scheme provided by the Act of 1935 was subjected to bitter criticism on many scores and from different directions. It was contended that the coverage was too limited and that the Act ought to be extended to include farm laborers, domestic servants, and other excluded groups. The structure of benefits was alleged to be inadequate. Though the system of benefits was arranged to favor those with low incomes and the relatively old, the actual payment of benefits was not to start until 1942, and at the beginning of that year the maximum available benefit was scheduled to be $25 a month. No one past forty-five could look forward to receiving an annuity of more than $56 a month, and

for most workers in this age group it promised to be much lower. No provision was made for disability benefits, for wives or dependents of retired workers, or for survivorship benefits to be paid to widows or dependent children on a continuing basis.

The method of financing old age insurance was also criticized. Under the system instituted by the Act of 1935, taxes levied in the early years were to yield considerably more than the amounts needed to support current benefit payments. The Act contemplated the growth of a reserve fund which was to accumulate until 1980, when actuaries estimated that it would reach the stupendous sum of $47,000,000,000. The reserve fund was to be invested in government obligations yielding 3 per cent interest. Under this scheme it was expected that the system would be largely self-sustaining, with the government contribution in the main limited to payment of interest on the reserve fund. Criticism was directed both against the projected tax schedules and the reserve fund. Some complained that the steeply rising payroll taxes would burden business and that the huge reserve fund would operate as an invitation to government spending and extravagance. Others argued that the payroll taxes were regressive in their effects, that they imposed undue burdens on poorly paid employees, and that the government ought to make a contribution toward the support of the insurance program through some form of general taxation based on ability to pay. At the same time it was pointed out that the reserve fund exercised a deflationary effect on the economy. For the three years 1937–39 estimates indicated an excess of tax collections over benefit payments of approximately $500,000,000 a year; for the next three years it was estimated that this sum would increase to $750,000,000 per year.[25] To this extent the reserve threatened to reduce mass consumption expenditures and to accentuate tendencies toward deflation.

As a result of the flood of criticism, Congress initiated action in February, 1937, to revise the program. The Chairman of the Senate Finance Committee appointed a special committee of three members to co-operate with the Social Security Board in studying the advisability of changes. This special committee, acting jointly with the Board, appointed an Advisory Council on Social Security, composed of six representatives of employees, six persons representing employers, and thirteen persons representing the public, to make recommendations. The Committee rendered its final report on De-

[25] A. H. Hansen, *Full Recovery or Stagnation?* (1938), p. 190.

cember 10, 1938.[26] Meanwhile, the Social Security Board also initiated studies and suggested proposed changes, and the Treasury addressed its energies to the financial aspects of the program.

The recommendations which emerged revealed surprising unanimity. The Social Security Board and the Advisory Council agreed that average old age benefits payable in the early years of the plan ought to be increased (but that the total cost of the new system be kept within the bounds of the old); that average wages rather than accumulated earnings be used as a basis for computing benefit payments; and that benefits be made available for wives of annuitants, widows, and dependent children. Both the Council and the Board recommended that old age payments begin on January 1, 1940, instead of 1942. Both approved disability insurance in principle, though neither recommended immediate application. Both recommended an immediate extension of coverage to include employees of nonprofit organizations and ultimate inclusion of farm and domestic employees in the system. The Board, the Advisory Council, and the Treasury all agreed on the desirability of eliminating the large reserve and of substituting a much smaller contingency reserve. The majority of the Council suggested that the cost of the old age insurance system be met by means of approximately equal contributions by employers, employees, and the government and that no change in the tax schedule under the Act be made until 1942, when more adequate information as to the effect of existing taxes would be available. The Social Security Board recommended the continuation of the existing tax schedule with provision for the use of supplementary government funds as they became necessary. The Treasury, on the other hand, with the support of a minority of the Council, opened up the possibility of an altered tax schedule before 1943 by pointing out that the contingency reserve fund would be adequate without a step-up in payroll taxes before 1943.

After extensive hearings, the old age insurance program was revised in 1939 in a number of important respects.

(1) Coverage was extended to include maritime service on American vessels and employment in national banks, state banks which are members of the Federal Reserve System, and federal building and loan associations. This action brought approximately 1,600,000 additional workers within the system. By the end of the fiscal year

[26] See *Final Report of the Advisory Council on Social Security* (1938).

1940, wage record accounts had been established for approximately 50,000,000 persons.

(2) The date of payment of the first monthly benefits was advanced from January 1, 1942, to January 1, 1940. This action was in accordance with the recommendations of the Social Security Board and the Advisory Council and met the complaints of delay in making the protection of the system available.

(3) The eligibility requirements for benefits in the early years were modified in the direction of greater leniency. Persons already old who would have been excluded under the original Act were enabled to qualify for old age benefits. The original law excluded employment after sixty-five; the law as amended allowed credit for employment after sixty-five and thus permitted many additional older workers to qualify for benefits during the first few years of benefit payments. With the passage of time, however, "the requirements of periods of covered employment become more exacting in order to limit benefits to persons who have participated substantially." [27]

(4) The average benefits payable in the early years of the system were increased. This was accomplished by a new formula for the determination of benefits which related benefits to average wages rather than accumulated wages. The employee's average monthly wage was to be determined by dividing his total accumulated wages (exclusive of amounts in excess of $3,000 per year) by the number of months he could have been under the system—that is, the number of months between 1936 (or his twenty-second birthday, if later) and the quarter in which he became eligible for benefits or died. The monthly benefit was to be 40 per cent of the first $50 of average monthly wage, plus 10 per cent of the next $200, plus an added 1 per cent for each year in which the individual received $200 or more in wages. The result of the application of this formula was to increase amounts payable in the early years and to give a relatively higher benefit to those with lower earnings.

(5) The amended Act extended protection to wives and dependent children of retired workers. Under the original law, single workers and married workers were entitled to the same benefits if their earnings were the same. Under the revised law supplementary benefits were provided for a wife sixty-five years of age or over and

[27] *Fourth Annual Report of the Social Security Board,* 1939, p. 171.

for unmarried dependent children under sixteen years of age, or under eighteen if regularly attending school. The supplementary benefit for each was one half of the worker's benefit; the total benefit available, however, was still limited to $85 a month. The following table gives illustrative examples of benefits payable under the original law and under the 1939 amendments.

TABLE II

OLD AGE AND SURVIVORS' INSURANCE:[28] ILLUSTRATIVE MONTHLY OLD AGE BENEFITS PAYABLE UNDER 1935 PROVISIONS OF THE SOCIAL SECURITY ACT AND UNDER THE 1939 AMENDMENTS.

Years of coverage	1935 act	1939 amendments: Without dependents	1939 amendments: With 1 dependent	1935 act	1939 amendments: Without dependents	1939 amendments: With 1 dependent
	Average monthly wage of $50			Average monthly wage of $100		
3	a	$20.60	$30.90	a	$25.75	$38.63
5	$15.00	21.00	31.50	$17.50	26.25	39.38
10	17.50	22.00	33.00	22.50	27.50	41.25
20	22.50	24.00	36.00	32.50	30.00	45.00
30	27.50	26.00	39.00	42.50	32.50	48.75
40	32.50	28.00	40.00	51.25	35.00	52.50
	Average monthly wage of $150			Average monthly wage of $250		
3	a	$30.90	$46.35	a	$41.20	$61.80
5	$20.00	31.50	47.25	$25.00	42.00	63.00
10	27.50	33.00	49.50	37.50	44.00	66.00
20	42.50	36.00	54.00	56.25	48.00	72.00
30	53.75	39.00	58.50	68.75	52.00	78.00
40	61.25	42.00	63.00	81.25	56.00	84.00

[a] Monthly benefits not payable until after five years of coverage.

As this table makes clear, the effect of the 1939 amendments is to increase monthly benefit payments for both single and married workers during the early years of the system. Later, however, the benefits available to single men are considerably decreased com-

[28] From *Fourth Annual Report of the Social Security Board*, 1939, p. 217.

pared with those which would have been available under the 1935 Act.

(6) The 1939 amendments also provided for survivorship benefits for widows and dependents. Under the original Act the lump-sum payments to the estates of deceased workers were largely based on a "money-back" principle and had no relation to the presumptive need of the recipient. The 1939 amendments eliminated most of the lump-sum payments and substituted instead protection for survivors whose need is greatest. When a fully insured individual died, survivors' monthly benefits were to be provided as follows: three fourths of the worker's benefit rate for a widow sixty-five or over, or for a widow with dependent children in her care; one half of this rate for each unmarried dependent child under

TABLE III

OLD AGE AND SURVIVORS' INSURANCE: ILLUSTRATIVE MONTHLY SURVIVORS' BENEFITS UNDER THE 1939 AMENDMENTS

Years of coverage	*1 child or parent aged 65 or over*	*Widow aged 65 or over*	*Widow and 1 child*	*1 child or parent aged 65 or over*	*Widow aged 65 or over*	*Widow and 1 child*
	Average monthly wage of deceased, $50			*Average monthly wage of deceased, $100*		
3	$10.30	$15.45	$25.75	$12.88	$19.31	$32.19
5	10.50	15.75	26.25	13.13	19.69	32.82
10	11.00	16.50	27.50	13.75	20.63	34.38
20	12.00	18.00	30.00	15.00	22.50	37.50
30	13.00	19.50	32.50	16.25	24.38	40.63
40	14.00	21.00	35.00	17.50	26.25	43.75
	Average monthly wage of deceased, $150			*Average monthly wage of deceased, $250*		
3	$15.45	$23.18	$38.63	$20.60	$30.90	$51.50
5	15.75	23.63	39.38	21.00	31.50	52.50
10	16.50	24.75	41.25	22.00	33.00	55.00
20	18.00	27.00	45.00	24.00	36.00	60.00
30	19.50	29.25	48.75	26.00	39.00	65.00
40	21.00	31.50	52.50	28.00	42.00	70.00

From *Fourth Annual Report of the Social Security Board,* 1939, p. 217.

eighteen; and one half for each dependent parent if there was no widow or dependent child. Monthly survivors' benefits were also to be provided for minor children and widows with such children in their care, if an insured wage earner had received $50 or more a quarter for at least six quarters during the three years prior to his death, even though he had not been fully insured. In the absence of survivors entitled to monthly benefits, the law provided for small death payments to certain relatives. The above table furnishes examples of monthly survivors' benefits available under the 1939 Act.

(7) Changes were also made in the financial framework of the old age insurance system. A federal old age and survivors' insurance trust fund was created to replace the old age reserve account, and supervision was vested in a Board of Trustees composed of the Secretary of the Treasury, the Secretary of Labor, and the Chairman of the Social Security Board. That portion of the fund not needed to meet current claims or administrative expenses was to be invested in United States government obligations; the former provision specifying payment of 3 per cent interest was eliminated. The tax schedule was also amended to continue the 1 per cent rate on employers and employees until 1943, when there was to be a step-up to 2 per cent. The effect of this change will be to reduce tax receipts for the years 1940–42 by approximately $825,000,000. In order to meet the rising scale of future benefit payments, it will be necessary to increase payroll taxes or make government contributions from general revenue, or both; otherwise, benefits may have to be reduced.

As a result of the enactment of the 1939 amendments, benefit payments promise to increase rapidly during the next years. Between January 1 and October 1, 1940, 238,578 claims for benefits were allowed. By 1945 it is estimated that 3,750,000 individuals will be receiving benefits amounting to $775,000,000 annually. Impressive as these figures are, they represent only a beginning, for beneficiaries and benefits will mount greatly as the system matures. At the same time pressure is already being exerted to extend the coverage of the system to groups which are at present excluded—employees of nonprofit organizations, workers in the public service who do not have retirement protection, agricultural and domestic workers, and the self-employed. Suggestions have been made that the system also be broadened to provide compensation for wage losses due to perma-

nent total disability, and it seems not unlikely that this additional protection will soon be afforded. As the system expands, the problem of financing benefit payments will probably present complex problems and the burden of supporting the system can be expected to give rise to sharp political differences among the groups affected.

UNEMPLOYMENT COMPENSATION

Unemployment compensation has been frequently described as a first line of defense in dealing with the problem of unemployment. It attempts to serve this purpose by building up funds through contributions during periods of relatively good employment and by drawing on these funds to pay out benefits to workers in periods of unemployment. Unemployment compensation needs to be distinguished from relief. Benefits are paid as a matter of right rather than charity and without resort to a "means test." Benefits, however, are available to eligible individuals for only a certain period of time. If a protected worker exhausts the benefits to which he is entitled without finding a job, he may be forced to go on relief. Unemployment compensation systems thus deal with problems of short-run rather than long-run unemployment. They may help to tide workers over temporary periods of unemployment and mild cyclical depressions. They may even contribute to mitigate cyclical fluctuations by adding to purchasing power in periods of depression and serving as a check in periods of expansion and boom. Given a prolonged crisis of continuous mass unemployment, however, unemployment compensation systems break down and have to be supplemented by relief or public works.

Though England adopted a national system of unemployment compensation in 1911 and many other industrial countries quickly followed her example, American interest in unemployment compensation did not develop seriously until the depression of the thirties. Prior to that time there had been some local experimentation with voluntary plans. A few trade-unions paid out-of-work benefits to their members. In some cases, particularly in the needle trades, provision was made for payment of unemployment benefits as a result of joint agreement between unions and employers. Some company plans for the payment of unemployment benefits were installed following the pioneer example of the Dennison Manufacturing Company in 1916. But workers covered by these voluntary

compensation plans probably did not constitute more than 1 per cent of the wage earners of the country.

With the prolonged depression of the thirties, the pressure for government action grew rapidly. In 1932, Wisconsin enacted the first state unemployment compensation law. Other states appointed commissions to study the problem and a number recommended the passage of unemployment insurance bills. In 1932 the A.F. of L. reversed its traditional role of opposition to state unemployment insurance and strongly approved a plan submitted by its Executive Council.

With the appointment of the President's Committee on Economic Security in 1934, the movement for unemployment compensation came to a head. The Committee was charged with the responsibility of framing a plan to be submitted to Congress. There was considerable disagreement as to what type of plan was most desirable. Should unemployment compensation be left to the states? Should a national system be adopted? Or was a system of federal-state cooperation to be preferred? The Committee decided in favor of the latter alternative. Leaving unemployment compensation to the states was regarded as too slow and uncertain because of the likelihood that the passage of laws would be blocked by the failure of some states to take action and the fears of others that action by them alone would involve the assumption of heavy competitive burdens. A national system was passed over because of fear that it might be held unconstitutional, because the Committee was not prepared to commit itself to any single nation-wide plan, and because it was impressed by the desirability of experimentation with different schemes in different localities.

As finally worked out by the Committee and enacted by Congress, the Social Security Act of 1935 provided a tax-offset plan which was designed to promote action by the states in accordance with certain minimum standards rather than to prescribe the provisions of state plans in detail.[29] A federal tax was levied on the payrolls of all covered employers with eight or more employees.[30]

[29] This plan was held constitutional by the Supreme Court in *Steward Machine Company* v. *Davis*, 301 U.S. 548 (1937). The constitutionality of state unemployment compensation laws was also upheld in *Carmichael* v. *Southern Coal and Coke Company* and *Carmichael* v. *Gulf States Paper Corporation*, 301 U.S. 495 (1937).

[30] Wages paid for certain types of employment were exempt from the tax. The exceptions included agricultural labor, domestic service, casual labor, government service, service on both American and foreign vessels, family employment, service for

In 1939 the Act was amended to exempt all wages over $3,000 a year from payment of the payroll tax. The result of this action was to save employers about $65,000,000 a year.

The tax was fixed at the rate of 1 per cent in 1936, 2 per cent in 1937, and 3 per cent thereafter. A credit up to 90 per cent of the tax was allowed to employers for contributions paid into state unemployment compensation funds under state laws which were found by the Social Security Board to meet the conditions prescribed by the Act. Out of the 10 per cent of the tax which was retained by the federal government, the Social Security Board was to make grants to support the administration of state unemployment compensation laws. There was no requirement that the state match this grant. Since taxes paid by employers in states failing to enact laws would have gone into the federal treasury instead of remaining within the state, the tax-offset device proved extraordinarily effective in stimulating state action. Within two years of the passage of the Social Security Act all the states had enacted legislation.

Under the Act of 1935, the laws passed by the states had to conform to certain minimum requirements. All compensation had to be paid through public employment offices or such other agencies as the Social Security Board approved. No compensation benefits could be paid until two years after contributions began to accrue. This requirement was designed to build up a reserve balance before benefits became payable. The state unemployment compensation funds were to be paid into an unemployment trust fund in the Federal Treasury and all money withdrawn by the states from this fund was to be used solely for unemployment compensation. This provision was designed to maintain the integrity of unemployment compensation reserves. Safeguards were also included to protect labor standards. States were forbidden to deny unemployment compensation benefits to eligible unemployed workers who refused to fill vacancies due to a labor dispute. Nor could such workers be required to accept wages, hours, or other conditions of work substantially less favorable than those prevailing for similar work in the locality, or employment conditioned on joining a company

non-profit-making charitable, religious, educational, and scientific organizations, service by newsboys under eighteen, and others of minor importance. In 1939, the Act was amended to include employment in certain federal instrumentalities, such as national banks and state banks which were members of the Federal Reserve System.

union or resigning from or refraining from joining a bona fide labor organization.

A second set of federal requirements could be imposed as conditions of eligibility for grants which the Board was authorized to make to the states. Thus, the Board was required to make certain that state plans provide methods of administration "reasonably calculated to insure full payment of unemployment compensation when due." As a result of the amendments of 1939, such methods of administration had to include the establishment and maintenance of personnel standards on a merit basis. In addition, the Board could require reports and prescribe reporting procedures, and it could impose detailed restrictions on the use of money granted for administrative expenses. The Act also stipulated that states guarantee all persons whose claims for benefits had been denied an opportunity for a fair hearing before an impartial tribunal. Information concerning recipients of unemployment compensation was to be provided to federal public works and work relief agencies upon request. After July 1, 1939, when the United States Employment Service of the Department of Labor was transferred to the Social Security Board, the Board also administered the Wagner-Peyser Act of 1933. This Act authorized annual grants to the states to assist in the establishment and maintenance of public employment offices and conferred broad authority on the United States Employment Service to prescribe minimum standards for their operation. These employment offices were designed to provide efficient placement service for unemployed workers without charge. Since the enactment of state unemployment compensation laws, the employment offices have also been widely utilized to certify eligibility for unemployment compensation benefits.

Under the Social Security Act the states were left considerable freedom to choose the type of unemployment compensation law which they preferred. They might adopt a pooled fund plan under which all contributions were paid into a single reserve fund from which all benefits were also paid; they might establish individual employer reserve accounts under which each employer's contributions were set up in a separate reserve account available only for the payment of benefits to his own employees; they might establish guaranteed employment accounts by which employers undertook to guarantee to their employees a minimum number of weeks of employment per year; or they might provide some method of ex-

perience rating designed to encourage the stabilization of employment and to adjust employers' contributions according to their unemployment experience. Where, however, employers' contribution rates were reduced under state laws by the application of experience rating, employer reserve account systems, or guaranteed employment plans, the provisions of these plans had to conform to minimum federal standards before employers whose rates were so reduced could obtain their full 90 per cent offset against the federal tax. For employer reserve account systems and guaranteed employment plans a sizable reserve had to be built up before the employer could qualify for reductions. For experience rating plans, the only condition established by federal law was that no employer's rate should be lowered except on the basis of three years' experience with the plan. Certification of eligibility for these reductions had to be made annually by the Social Security Board.

While the Social Security Act left the states considerable leeway in drafting legislation and administering their acts, in actual practice, particularly at the beginning, the influence of the Social Security Board was much greater than the language of the Act perhaps implied. Because unemployment compensation was a highly technical subject to which little serious consideration had been given and with which there was practically no American experience, the states relied heavily on the Social Security Board for technical service and advice. The Board prepared a Draft Bill which was submitted to state officials and became the basis for many state unemployment compensation laws. This bill left the states a choice between a pooled fund and an employer reserve account plan. This choice involved perhaps the most controversial issue in the enactment of the early unemployment compensation laws. Most employer groups usually preferred employer reserve account plans while organized labor insisted on a pooled fund to spread the risk. Officially, the Social Security Board was neutral on this issue, though there were indications that pressure was exerted by the Board on behalf of pooled funds. After 1938, the states showed much more independence in shaping their own laws. As experience accumulated state officials developed their own ideas as to desirable changes. Outside labor and business groups also became better informed and more active. The trend since 1938 has been definitely in the direction of greater diversity and not infrequently along lines opposed by the Social Security Board.

As changes were made, the provisions of state laws developed great variety in coverage, in provisions for contributions and reserves, and in benefit structures. With regard to coverage, most states tended to exclude the types of employment exempt from the federal tax. The major differences in state laws were in the size of establishments exempted. In 1940, twenty-five states followed the federal tax provision and applied their laws only to employers having eight or more employees. In eleven states, however, coverage extended to employers having only a single worker, and in the remaining states various intermediate degrees of coverage were provided. The result was to produce some inequity in the treatment of workers and employers in different parts of the country. Provisions for contributions also varied. While all states required employer contributions, five states also provided for employee contributions, which were usually levied at a rate of 1 per cent on earnings and collected from the employer as a deduction in wages.

There was also considerable variety in the provision for reserves. Most states adopted the pooled fund plan, though a few followed the Wisconsin example of individual employer reserve accounts. Where the latter plan was adopted, there was usually provision for small pooled funds for the payment of benefits when individual accounts became exhausted. In a large majority of the states, the pooled fund plan was combined with various kinds of experience rating schemes, by which employers' contributions were adjusted according to their unemployment experience. Under some of these plans, a better than average unemployment experience produced a reduction in the employer's contribution rate below the normal 2.7 per cent, while a worse than average experience brought no increase in rates. Such one-sided experience rating plans met strong opposition from labor groups on the ground that they operated as "a thin disguise for reducing taxes and preventing the extension or liberalization of benefits." [31] In general, labor opposed any form of experience or merit rating on the theory that unemployment ought to be treated as a social risk and that any attempt to allocate responsibility for unemployment to individual employers was likely to be futile and harmful to labor's group interests.

There were also considerable divergences in the benefit structures provided by state unemployment compensation plans. To be eligible

[31] C.I.O. Resolution adopted November 18, 1940, quoted in *Social Security,* January, 1941, p. 5.

for benefits, workers had to have a specified minimum amount of insured employment during a preceding base period. This amount was usually measured in earnings. It ranged from a negligible sum in a few states to as high as $300 in California. The average was between $100 and $200. In order to qualify for benefits an unemployed worker had to register with a public employment office for placement, file a claim, and serve a waiting period of one to three weeks before he became entitled to compensation. In most states benefits were paid on a weekly basis and were ordinarily adjusted at a fixed percentage of the worker's full-time earnings. After 1938, the trend was definitely toward diversity in benefit provisions. In North Carolina the minimum weekly benefit was $1.50, while in California it was fixed at $10. While most states paid maximum weekly benefits of $15, in five states the maximum was $18. The maximum duration of benefits varied from twelve weeks in Missouri to twenty-six weeks in California. In many states the duration of benefits was further restricted by provisions that the amount payable during a twelve-month period was limited to a certain fraction of earnings in the preceding year. The practical result was frequently to keep actual maximum payments well below the legal maximum.

All but four states provided some benefits for partial unemployment. Workers were deemed partially unemployed in weeks in which their hours of work were reduced and earnings were less than an amount approximating or slightly greater than their benefit rate for total unemployment. Benefits paid per week were usually measured by the difference between actual earnings and this amount. In New York and Pennsylvania, two of the most important industrial states, provision for partial unemployment benefits had not yet been made in 1940. The problem of administering such payments was complex and many states encountered real difficulty in carrying out the scheme.

The experience with unemployment compensation in the United States is still too short to furnish a basis for more than tentative judgment. In the year ending June 30, 1940—the first in which all states paid benefits—administrative expenditures of state agencies amounted to about $65,550,000, approximately 6.8 per cent of the proceeds of payroll taxes collected by state and federal governments for unemployment compensation. Some 28,000,000 workers were covered by the system. A total of 810,000 employers paid $810,000,-

000 into state unemployment compensation funds, which, together with the $44,000,000 contributed by employees in six states, provided a total of $854,000,000 paid in for the year. During this period $482,500,000 was paid out in benefits to approximately 5,000,000 persons. Total reserves in all states at the end of 1940 amounted to about $1,750,000,000. By January 1, 1942, it is estimated that total reserves will increase to about $2,400,000,000, a sum capable of taking care of five years of payment at the level of benefits paid out during the fiscal year 1939–40. These are, of course, over-all figures and do not necessarily reflect the status of individual state funds. Thus, during the first nine months of 1940, eight state jurisdictions paid out in benefits more than they collected in contributions, while fourteen jurisdictions paid out less than 50 cents on the dollar. In general, however, the tendency has been to build up rather than to exhaust reserves.

Because of the large reserves which have been accumulated in many states, employer groups have pressed strongly for tax reductions. In view of the existing low scale of benefits and their limited duration, the Social Security Board has taken the position that this would be undesirable and that the direction of progress lies rather along the lines of extending coverage and making benefit payments more adequate.[32]

The federal-state system of unemployment compensation adopted in the United States has already produced some complications which deserve emphasis. Administration is divided among fifty-three state and federal agencies. In addition, there is a separate system of unemployment compensation for railroad employees which is operated by the Railroad Retirement Board.[33] If unemployment compensation is extended to maritime workers, there is a possibility of the creation of yet another federal system. The division of jurisdiction among these diverse systems inevitably produces overlappings, conflicts of authority, and administrative complexities. The problems

[32] See A. J. Altmeyer, "Liberalizing Unemployment Compensation," *Social Security Bulletin,* January, 1940, p. 3.

[33] The Railroad Unemployment Insurance Act of 1938, as amended in 1939 and 1940, provides a national pooled fund system of unemployment insurance for railroad workers. The system is supported by an employer-paid tax equal to 3 per cent of the compensation of railroad employees, excluding compensation in excess of $300 a month. Administration is vested in the Railroad Retirement Board and is co-ordinated with the administration of the Railroad Retirement Act. The benefit structure provided by the Railroad Unemployment Insurance Act is indicated in the following table:

of interstate employment create confusion. The interstate employer is compelled to cope with many state laws which vary in their requirements. The Railroad Law adds to the confusion. There are borderline cases where employers and employees may be subject to both railroad and state laws. There is duplication in tax and wage reporting and paper work is multiplied. While some of these problems can be and have been minimized by joint agreements among states, many are inherent in the decentralized pattern of organization which the present system of unemployment compensation provides.

Even more serious than the problem of administrative complexity is the tendency of the system to develop diversity in contribution and benefit provisions. This tendency is explained by various factors. The alignment of political forces in different states varies, and variations in the strength of business or labor groups breed differences in state laws. The relative wealth or poverty of a state and the peculiarities of its industrial pattern also induce variety. In some states the industrial structure may be such as to provide relatively stable employment; in others there may be violent fluctuations in employment. An anomalous result of such a condition may be that the most generous benefits become available in states with the most stable employment records, while benefits become most inadequate where unemployment is most severe and workers have the greatest need of protection. While it may be argued that differences in state laws are justified by differences in underlying wage scales and living costs, the result is variation in the treatment of the same kind of employees in different states and variations in the treatment of bus-

Total compensation in base year	*Daily benefit rate*	*Maximum benefits payable in a*	
		Registration period of 14 days	*Benefit year*
I	II	III	IV
\$150 to \$199.99	\$1.75	\$17.50	\$175
\$200 to \$474.99	2.00	20.00	200
\$475 to \$749.99	2.25	22.50	225
\$750 to \$999.99	2.50	25.00	250
\$1,000 to \$1,299.99	3.00	30.00	300
\$1,300 to \$1,599.99	3.50	35.00	350
\$1,600 and over	4.00	40.00	400

iness competitors. The latter particularly offers an incentive to the states to engage in a competitive reduction of benefit scales and contribution rates.

While it is argued by many that a national system of unemployment compensation would result in considerable simplification of administration, assure uniform treatment of workers and employers, make certain that adequate benefits were available where they were most needed, prevent competitive reduction in benefits, and spread the cost of unemployment more evenly over the entire economy, there appears at present to be little likelihood that a national system will be adopted. The states have acquired vested rights in the present arrangement and whatever improvements are made are likely to be built on the present system as a foundation. Bills which impend in Congress indicate that changes are likely to be in the direction of providing additional national minimum standards to which state plans will have to conform, and perhaps supplying a federal reinsurance or equalization fund which can be used to assist states which are unable to bear the full cost of adequate unemployment compensation benefits.

THE MOVEMENT FOR HEALTH INSURANCE

In Europe health insurance was one of the first types of social insurance to be adopted. In the United States, in 1940, health insurance was still on the agenda for future action. After the passage of the British health insurance law in 1911, a lively health insurance movement began in the United States. Bills were introduced in a number of state legislatures and commissions appointed to investigate the proposal, but as a result of powerful opposition on the part of industrial insurance companies and some medical societies no action was taken and interest died down. This interest revived during the period when the Social Security Act was being prepared. Although some groups hoped that the Social Security Act would include a health insurance plan, as a result of the active opposition of the American Medical Association, no such plan was provided when the bill was presented to Congress. Instead, as has been noted earlier, there was provision for federal grants for public health work, infant and maternal hygiene, and care of crippled children. There was relatively little opposition to these provisions.

After the passage of the Social Security Act, the President appointed an Interdepartmental Committee to Co-ordinate Health

and Welfare Activities. This committee in turn appointed a subcommittee, the Technical Committee on Medical Care. In February, 1938, the Committee submitted two reports, *The Need for a National Health Program* and *A National Health Program,* which proposed a ten-year plan for federal grants-in-aid to encourage health work in the states. These reports were transmitted with a message from the President to Congress on January 23, 1939,[34] and embodied in a bill which was introduced by Senator Wagner. This bill took the form of an amendment to the Social Security Act and proposed federal grants to the states for five general purposes: (1) maternal and child health services; (2) state public health work; (3) hospital and health center construction; (4) temporary disability compensation; and (5) medical care. Under the last item, states were to be encouraged to establish health insurance systems, plans for medical care of the needy, or systems of public medical care for the whole population. The bill contemplated total federal expenditures of $425,000,000 per year when the program reached its maximum. Since the states and localities would be required to raise equal amounts, the total maximum cost would have been $850,000,000 per year.

This proposal, particularly in so far as it made possible the enactment of state compulsory health insurance laws, met strong opposition from powerful groups in the medical profession, and by the beginning of 1941 no action had been taken. The main developments in the field of medical care, meanwhile, were in the direction of voluntary health insurance, especially group hospitalization. But compulsory health insurance bills continued to be actively pressed and their advocates looked forward to ultimate victory.

4. The Quest for Security

As the developments reviewed here indicate, the quest for security in recent years has taken the form of increased dependence on government to provide at least the minimum conditions of economic well-being. The movement has been world-wide in scope. In most industrial nations the pressure on government to provide a measure of economic security has resulted in a tremendous expansion of public activities in the social welfare field.

The symbol of security has come to epitomize the aspirations of

[34] H. Doc. 120, 76th Cong., 1st Sess.

large numbers of people in many lands. Democratic and constitutional governments that have proved unable or unwilling to satisfy these aspirations have lost popular support and fallen easy prey to exponents of dictatorial regimes. Constitutional democracies which have taken vigorous measures to deal with problems of mass unemployment and economic disintegration have consolidated the loyalties of their citizens and erected safeguards against the extravagant promises and allurements of dictatorship.

During the thirties the provision of social security became one of the paramount concerns of public policy in the United States. The effect of depression and large-scale unemployment caused many individuals to turn to government for leadership in supplying the conditions of stable economic development. Unemployed workers demanded that government provide relief and work. Employed workers sought protection against the dangers of temporary unemployment. The old and the "near-old" organized effectively to obtain relief from the fear of poverty in old age. A new conception emerged that government, under the conditions of modern industrialism, was vested with a responsibility to provide security against the hazards of unemployment, accident, illness, and old age.

The "permanent" character of the new obligations assumed by the federal government received symbolic recognition in 1939 with the creation of two new agencies, the Federal Security Agency [35] and the Federal Works Agency.[36] Emergency work relief programs were being transformed into a permanent public works policy. Public assistance, old age insurance, and unemployment compensation were being welded together into a systematically integrated program.

Judgments differ as to the wisdom of much of the new security legislation. There are some who are reluctant to recognize any government obligation to provide security. There are many who question whether the real income of the country can justify the social

[35] The Civilian Conservation Corps, the National Youth Administration, the Social Security Board, the Public Health Service, the Office of Education, and certain other minor activities were incorporated in the Federal Security Agency in 1939. In 1940 the Food and Drug Administration, St. Elizabeth's Hospital, Freedmen's Hospital, Howard University, and Columbia Institution for the Deaf were transferred to the Agency.

[36] The units brought together under the Federal Works Agency are the Public Roads Administration, the Public Buildings Administration, the Public Works Administration, the United States Housing Authority, and the Work Projects Administration (formerly the Works Progress Administration—W.P.A.).

dividends which the government has attempted to declare. There are others who regard these dividends as an investment in national well-being and even as a road to economic expansion. On these questions time alone can speak the final word.

But whether particular security legislation be deemed wise or unwise, it seems hardly likely that the substance of this legislation will be abandoned. The new obligations which have been assumed by government have been a response to felt needs. The responses have been in many cases tentative and experimental, and many provisions of the new security legislation may have to be altered as experience reveals defects and points the way to improvement. But the underlying purposes appear to have won widespread acceptance and to have become a part of the pattern of community thinking to which the economy will have to make its adjustments.

Chapter Twenty-Two. CONCLUSION—PUBLIC POLICY AND THE AMERICAN ECONOMY

1. The Evolution of Public Policy

Public policy over the years has come to play an increasingly significant role in giving shape and content to the American economy. This development, however, is neither novel nor recent in origin. In every generation diverse economic groups have sought, in greater or less degree, to utilize the instrumentalities of government to guide and direct the course of economic development. Even before the Constitution was ratified an acute statesman like Madison recognized that "the regulation of these various and interfering interests forms the principal task of modern legislation. . . ."

Public policy, as embodied in fundamental constitutional provisions for the maintenance of order, the protection of property rights, and the enforcement of contracts, contributed to the establishment of the legal framework for the growth of business enterprise. In the first decade of our national history, the economic program sponsored by the dominant Federalist Party furnished an important impetus to the growth of banking, mercantile, and manufacturing interests. Such Hamiltonian policies as the establishment of a national bank, the funding of the public debt, and the enactment of a protective tariff were consciously designed to achieve this end.

In the period from Jefferson's inauguration in 1801 until the outbreak of the Civil War, agrarian interests were in the ascendancy. The expansion of the frontier and the widening of the suffrage favored the growth of agrarian influence. Agrarian statecraft in its

initial phase, however, did not operate to impede the growth of manufactures or the spread of business influence. Indeed, in the desire to liberate the United States from dependence on foreign and particularly English-fabricated goods (a motive which became particularly strong during and after the War of 1812), every encouragement was held out to the proprietors of manufacturing enterprises. Until 1832 the tariff rose steadily and proved a potent influence in accelerating the early stages of the American industrial revolution. The subsequent lowering of the tariff was largely a response to the pressure of Southern plantation owners, who became increasingly aware that they stood to gain by a low tariff policy which would facilitate the sale of cotton in foreign markets and at the same time reduce the price of manufactured articles in the domestic market.

The content of public policy in the pre-Civil War period had to be fitted to an agrarian mold. Public aids to promote the building of roads, canals, and later railroads found their strongest political support in the demand of farmers for improved transportation facilities. While business interests might also benefit from such improvements, agrarian well-being furnished the immediate justification. At the same time, the dominant agrarian leadership was prepared to rebuff the efforts of banking and business groups to use the instruments of central government to advance their interests unduly. The Jacksonian war on Biddle and the Second Bank of the United States was such a rebuff. It arose, not only out of agrarian demands for easier credit which the Bank was unwilling to meet, but also out of a deep-seated fear of the Bank as an engine of undesirable concentration of power. But while agrarian spokesmen were prepared to struggle to dislodge opposing economic interests from positions of economic and political influence in the central government, they envisaged government in less positive terms than the followers of Hamilton. In so far as they depended on government, they preferred to utilize it at the local and state level, rather than at the national center.

Over much of the pre-Civil War period Western and Southern agrarian interests maintained an effective working political liaison which ensured their dominance. As the slavery issue came into prominence, however, and the conflict over the disposition of the Western lands intensified, agrarian interests began to divide along sectional lines. The inability of the Democratic Party to find a formula that would keep its Southern and Western wings together

prepared the way for a political realignment. Under the aegis of the Republican Party, a new political alliance was achieved between the agrarian interests of the West and the business, banking, and industrial interests of the East.

With the triumph of the Republican Party in 1860, public policy began to reflect the aspirations of the new dominant combination. The thrust of public policy was double-pronged. Western agrarian interests received recognition in the enactment of the Homestead Act of 1862, the Land Grant College Act of the same year, and, also in 1862, the establishment of the Department of Agriculture as a service agency for farmers. At the same time, policies of liberal internal improvements and extensive government aid to advance railroad construction in the West were also calculated to appeal to Western agrarian interests. Concern with the promotion of business interests was even more immediate and direct. The steady elevation of the tariff became a powerful weapon in safeguarding many business enterprises against foreign competition. Monetary and banking policies contributed to the strengthening of the position of business and financial groups. Land grants and other public aids fostered the growth of railroad corporations. Business promotionalism bulked large in determining the direction of public policy.

During the eighteen-seventies signs of a shift in public policy became apparent. Promotionalism began to give way to regulation. Agricultural depression accentuated cleavages of interest between railroads, processors, and other business interests, on the one hand, and farmers, on the other. The appearance of pools, combinations, and monopolies in important sectors of the economy drove nonparticipating small businessmen to turn to government to restore a competitive order. Increasingly farmers and independent small businessmen were driven to find common cause. The first important manifestation of the growing regulatory movement, the Granger agitation, was primarily agrarian in origin. Its most significant contribution was in the field of state railroad regulation, where it elaborated a pattern of control of rates and practices which was later to be widely applied to other so-called public utilities in more comprehensive and positive terms.

Difficulties encountered in applying state regulation to businesses which transcended the jurisdiction of the states forced the advocates of regulation to invoke federal power. Thus in the eighties independent businessmen joined with farmers in pressing for federal

regulation of the railroads. The establishment of the Interstate Commerce Commission in 1887 marked a response to these demands. The enactment of the Sherman Antitrust Act of 1890 registered the influence of the same combination of farmers and small businessmen. However, the first great thrust of national regulatory power —symbolized by the passage of the Interstate Commerce Act and the Sherman Act—soon exhausted itself. During the nineties both the Interstate Commerce Commission and the Sherman Act met frustration in the courts. While agrarian discontent found a sounding board in Populist rumblings and the Bryan-led democracy, the dominant political leadership of the day was content to let well enough alone.

The second expansion of national regulatory power had to wait for the leadership of Theodore Roosevelt. In his administration a number of new regulatory responsibilities were assumed by the federal government. An effort was made to inject life into the Sherman Act. The passage of the Hepburn Act marked the beginning of effective railroad regulation by the I.C.C. For the first time the problem of conservation of natural resources was seriously attacked. Labor received recognition in the passage of the Employers' Liability Act. Consumer interests found expression in the enactment of the Meat Inspection and Pure Food and Drug laws. At the same time, a number of states enacted laws providing for the establishment of Commissions to regulate the rates and services of utility companies, and state legislation designed to improve the conditions of labor began to appear on a significant scale.

After a period of slackened tempo under Taft, the expansion of federal economic power was resumed with Wilson. This time the New Freedom served as the rallying cry for agrarian, small business, and labor forces. Again instrumentalities of national power were invoked. The Federal Reserve Board, the Federal Trade Commission, the Federal Farm Loan Board, the Tariff Commission, and the Federal Power Commission were among the important new additions to the structure of controls. The Clayton Act was designed to increase the effectiveness of antitrust policy and at the same time to liberate labor from some of the restrictions of the injunction and of antitrust legislation. The increased strength of labor was also reflected in the enactment of two federal child labor laws, which were later declared unconstitutional by the Supreme Court. The War emergency of 1917–18 concentrated a hitherto unparalleled

accretion of economic power in the federal government; although many of the specially created war agencies were subsequently demobilized, a residue remained. Wartime experience influenced the strengthening of the powers of the I.C.C. under the Transportation Act of 1920. The activities of the Shipping Board persisted into the postwar period.

The decade of the twenties was ushered in with the slogans of "Back to Normalcy" and "Less Government in Business," but the dominant political leadership of the day was only partially successful in arresting the trend toward increasing the responsibilities of the federal government in the economic realm. Thus, in 1924, the Inland Waterways Corporation, the residuary legatee of a public enterprise undertaken to relieve transportation shortages during the war, was established on a permanent basis. The postwar agricultural readjustment and depression produced insistent demands from farm leaders for federal assistance. Although the more ambitious of these proposals failed to become law, there was a partial response in the enactment of the Packers' and Stockyards Act of 1921, the Capper-Volstead Act of 1922, the Agricultural Credit Act of 1923, the Co-operative Marketing Act of 1926, and the Agricultural Marketing Act which established the Farm Board in 1929. Technological necessities reinforced the clamor of the radio industry and the listening public to produce the Federal Radio Commission of 1926. In 1930 the Federal Power Commission, originally a cabinet committee, was reorganized and made independent. These and other analogous developments of the twenties were neither large nor peculiarly significant in terms of their impact upon the total economy; what gives them particular interest is that they reveal the continuing strength of the forces making for expanded control even in a political environment which was ostensibly hostile to such expansion.

With the depression of 1929, forces were set in motion which produced a surge of federal economic power unparalleled in scope and purpose. As the depression deepened, public policy was pushed far beyond the traditional regulatory techniques which had been elaborated in the field of public utility regulation and antitrust policy. The dominant concern became the stability of the whole economy; the problems which called for action transcended the boundaries of any single industry. Public policy was increasingly forced to address itself to broader issues of large-scale unemployment and prob-

lems of conservation of natural and human resources, to ways of stimulating production and new investment, to wide-ranging problems of the interrelations of wage policies, price policies, and trade practices in fostering a return of prosperity and an increase in national income.

The initial response of public policy to the depression was couched in purely emergency terms. Under Hoover the Reconstruction Finance Corporation was organized to give assistance to banks, railroads, insurance companies, and other enterprises which were threatened with insolvency. Vain efforts were made to stabilize the price of some agricultural commodities through purchasing programs sponsored by the Federal Farm Board. An ambitious public works program was inaugurated. As local and state resources were exhausted, federal funds were made available for unemployment relief.

The New Deal's response to the depression was on a broader scale. The R.F.C. widened its activities, though emergency salvaging operations continued to be stressed. Public credit was extensively used to prevent farm and home foreclosures, to finance public works, and to provide relief for the unemployed. Promotional activity was markedly expanded in the agricultural and labor fields. Agricultural control legislation was focused on improvement in farm income, and government-sponsored farm credit facilities were considerably extended. In the labor field, Section 7(a) of the National Industrial Recovery Act and the activities of the National Labor Relations Board furnished a powerful stimulus to labor organization, and important laws such as the Walsh-Healey Act and the Fair Labor Standards Act were enacted to improve wages and working conditions. Additional consumer protective legislation was provided, of which the most important was the Food, Drug, and Cosmetic Act of 1938.

Many new regulatory controls appeared on the scene. In transportation, the jurisdiction of the I.C.C. was broadened to embrace motor and domestic water carriers as well as railroads. Air carriers and the merchant marine were subject to additional controls, though legislation in this field was primarily promotional in character. In communications, a new agency, the Federal Communications Commission, was created to replace the old Radio Commission, and it was vested with considerable power to regulate interstate telecommunications. Changes in the public utility field were even more sig-

nificant. The jurisdiction of the Federal Power Commission was expanded to embrace interstate activities of electrical and natural gas companies. The Securities and Exchange Commission was vested with power to regulate utility holding companies and to secure simplification in their corporate structures and geographical integration in their operations. There was a vast expansion of public enterprise in the electrical utility field, and public ownership became a significant regulatory device in the drive to reduce electrical rates.

Developments in the area of trade regulation followed a contradictory course. After the mammoth National Recovery Administration experiment in government-sponsored cartelization was dealt its deathblow by the Supreme Court, public policy at first wavered and then, after the depression of 1937, found new direction in a vigorous revival of the antitrust laws. At the same time, independent retailers and wholesalers joined with sympathetic manufacturers to secure legislation to remove some of the competitive advantages of large-scale distributors. The struggle to control the channels of distribution was waged in both federal and state jurisdictions. A number of states enacted laws providing discriminatory chain store taxation, and many more enacted fair trade acts which were designed to legalize resale price maintenance and outlaw price discrimination. The same impulse to remove the differential advantages of the mass distributor led to the enactment of the federal Robinson-Patman and the Miller-Tydings Resale Price Maintenance laws.

During this same period the range of regulatory authority was being expanded into new fields. Bituminous coal was subjected to a special regulatory regime which embraced perhaps the most complex venture in price fixing ever undertaken by any single governmental agency in the United States. In the case of oil, production restraints in the form of state proration laws, which had begun to be enacted earlier, were extended and supplemented by a federal prohibition of interstate shipment of oil produced in violation of state proration laws.

Novel and far-reaching changes were also evident in the form of an expansion of public enterprise and increased concern with the conservation of natural and human resources. Public enterprise became particularly important in the banking and credit field, in electricity, and in the provision of low-cost housing. The device of the public corporation, which had been widely used abroad and which had been resorted to for emergency purposes during the War of

1917, was increasingly employed in the organization of public enterprise. Conservation of natural resources bulked increasingly important, and a powerful impulse was given to the development of machinery to secure the planned utilization of land, water, and mineral resources. Concern with the conservation of human resouces was even more strongly evident. From haphazard and makeshift measures, public policy gradually moved to the stage of making systematic provision for old age, unemployment, and other risks through such measures as old-age insurance, unemployment compensation, regularized public assistance, work relief, and long-range programs of public works.

This vast increase in the economic responsibilities of government has been attended by significant modifications in the structure of controls in the American economy. Government has come to play a far more important role than it did a half century or even a decade ago. In such important areas as banking and credit and electricity public enterprise has been developed to supplement private enterprise; in other areas, such as slum clearance and low-cost housing, public enterprise has pioneered to undertake hitherto unrecognized responsibilities.

Governmental economic policies affect the conduct of private economic enterprise directly and continuously. When government undertakes to provide a measure of security to its citizens, the fiscal implications of its program have important consequences on wage, price, and output policies throughout the economy. When government undertakes to provide for the conservation of natural resources, the freedom of private entrepreneurs to make their own plans is necessarily limited. While the extent of governmental intervention varies in different sectors of the economy, the impact of public policy is widely felt, and in some areas it is of crucial significance.

The ways in which government impinges on the operations of the economy show considerable variations. Techniques of control embrace such diverse methods as enforcement of competition through the antitrust laws, direct price fixing as in coal, milk and the utility field, control of supply as in agriculture and oil, providing information as under the Securities Act, implementing the legal status and strengthening the bargaining position of weaker economic interests as in the labor and agricultural fields, a species of cartelization as under the now defunct NRA, licensing as in radio broadcasting

and in the security markets, subsidies as in agriculture, ocean shipping, and air transport, government competition as in the power and credit fields, and government purchasing as in the setting of labor standards under the Walsh-Healey Act. The result of these developments has been to produce a "mixed" economy, an economy in which public enterprise, partially government-controlled private enterprise, and relatively uncontrolled private enterprise all exist side by side.

2. Problems of a "Mixed" Economy

Clearly an economy so constituted presents problems which are dictated by its special character. These problems may be embraced under three heads: (1) the problem of adjustment between the public and private sectors of the economy, (2) the problem of clarifying the objectives of public policy, (3) the problem of developing effective instruments to implement public policy.

In a political system in which organized economic interests find free expression, no single pattern of relationships between government and private economic enterprise can be forever ordained as fixed and unalterable. As the preceding survey has indicated, the recent New Deal expansion of the economic powers of government represents an adjustment to the demands of political forces and disadvantaged groups which have been stirred to activity by a severe depression and a slow economic recovery. The altered framework of relationships between government and business has produced serious tensions which express themselves in the existence of widespread mutual distrust between government and business leaders.

Such tensions are perhaps the inevitable accompaniment of a period of rapid change. The increased responsibilities which have been assumed by government run counter to previously accepted tenets of the proper nature and scope of business leadership. The resultant frictions and cleavages have destructive potentialities in terms of community well-being. They present a challenge to constructive statesmanship on the part of both business and government.

It has been fashionable in some circles to insist that efforts to mingle public enterprise and public control with private enterprise are doomed to futility. Some proponents of the Either-Or method of analysis argue that the only ultimate choice is between complete

government regimentation on the one hand, or wholly unrestricted and uncontrolled capitalism on the other. While this line of argument may have a certain polemic value in controversy over public policy, it is doubtful whether any substantial body of opinion would be prepared to recognize its rigorous consequences in terms of practical application. Certainly, the bulk of the American electorate appears committed to an intermediate position which seeks to preserve civil and political liberties and the advantages of private enterprise at the same time that it utilizes government to provide basic securities and to guide entrepreneurial dynamics in the direction of economic expansion and community welfare.

Stress on such values excludes the possibility of totalitarian economic planning. This intermediate view looks upon government and business not as antagonistic, but as complementary functions of society, each requiring the effective working of the other in order to perform its own task successfully. Recognizing the basic importance of a healthy business system, it affirms the dependence of business health upon the economic health of the other large economic groups—farmers, workers, middle class, and consumers. It looks to government as the only social agency, however imperfect, which represents all these various economic interests, as well as noneconomic ones, and which is in a position to make those necessary adjustments between the parts of the economy which no longer occur automatically, if they ever did.

That these adjustments have been made imperfectly is verified by experience. Despite unprecedented governmental activity in the decade which succeeded the Great Depression of 1929, substantial portions of our resources of capital and labor remained idle. The full possibilities of synchronizing governmental and business efforts to overcome economic maladjustments were not adequately realized.

In the course of the transitional readjustments of the thirties, the problem of clarifying the objectives of public policy became acute. Some business leaders viewed the New Deal as an enemy of business and feared the displacement of private enterprise by a socialized state. Within the New Deal itself there were dispersive tendencies. The pulling and hauling of interest groups found expression in public policy. The development of policy was haphazard, experimental, at times even erratic, but always in the direction of recognizing that government had positive responsibility for the well-being of the economy.

Conflicting programs of economic control vied with each other for acceptance, and the flow of public policy registered their shifting popularity. Advocates of industrial self-discipline were provided with an experimental laboratory in the NRA. Those who placed their faith in a revival of world trade concentrated their energies on the enactment and administration of the trade agreements program. From the beginning great stress was placed on fiscal controls. Some emphasized currency devaluation and other forms of monetary manipulation as a road to recovery. Others placed their main reliance on pump-priming and deficit financing as a method of increasing purchasing power and national income. Still others viewed the problem as primarily one of chronic oversaving and underinvestment and placed their hopes on stimulating new private investment in plant and equipment and on a long-range program of public investment in productive public works and social services. In addition, there were those who emphasized tax reforms—proposals to tax idle savings and undistributed corporate profits, to increase income and inheritance taxes, and to repeal tax deterrents to new investment.

Further views which found expression were based on strengthening the bargaining power of weaker economic interests. Thus, farm leaders sought an increased share of the national income through subsidies, loans, production controls, and other measures. Labor leaders registered their influence on public policy by obtaining government support for collective bargaining and legislation designed to raise wages, lower hours, improve working conditions, and provide a measure of social security.

A school of thought which was increasingly influential after 1937 stressed antimonopoly policy as a primary means of achieving full employment. Representatives of this school sought to restore competition and flexible prices by vigorous enforcement of the antitrust laws. Others questioned the possibility of restoring competition through the antitrust laws and suggested instead that, in areas where price competition had broken down, public policy ought to turn either to regulation of the public utility type, despite its admitted difficulties of divided responsibility, or to public competition as a regulatory device.

Out of the maelstrom of these proposals, and the crosscurrents of public policy in which they were reflected, there gradually began to emerge a core of agreement which a substantial proportion of the

electorate was apparently prepared to endorse. This area of agreement may be briefly summarized:

(1) Public policy should be directed toward the maintenance of competition over as wide an area as possible, on a plane of minimum fairness and commercial decency; where competition is ineffective, it should be replaced by positive regulation of price policies or other special treatment.

(2) Government should fix reasonable minimum wages and maximum hours, eliminate child labor, and provide adequate care for the aged and the helpless.

(3) Government should accept an obligation to provide relief for the chronic depression of the farm population and to improve the position of agriculture in the national economy.

(4) Government should guarantee the provision of adequate basic services, preferably through private enterprise, but if necessary by providing them itself. Such services include at a minimum transportation, communications, and energy supply. They may be interpreted by some to embrace housing and health services as well. In general, the accepted area for public enterprise may be taken to include all desirable functions which private enterprise cannot or will not perform satisfactorily, together with those for which public enterprise is better suited by the inherent nature of the operations involved.

(5) Government should be charged with the responsibility of conserving natural and human resources and of taking measures to prevent economic stagnation or retrogression. While agreement on the precise content of these measures may be difficult to obtain, the recognition of the responsibility has become widespread.

(6) Government should be viewed not as a substitute for private enterprise, but rather as a positive guiding force, helping to adjust the economy to the needs of the basic economic groups—consumers, agriculture, labor, and business—to whom it is directly responsible.

The effective discharge of these functions poses the problem of instruments, of the establishment of adequate administrative machinery to develop far-sighted and co-ordinated policies. The expansion of governmental activities creates two types of administrative needs: (1) the need for specialization and differentiation in machinery to fit the diverse requirements of government intervention in different areas of the economy; (2) the need for co-ordination to ensure that the policies which are developed in different areas of

the economy follow a common stream of tendency and avoid needless conflict.

The heightened responsibilities of government in the modern economy place a special premium on the skill and ability of administrators. As Graham Wallas once said: "Governments have come to be engaged not merely in preventing wrong things from being done, but in bringing it about that right things shall be done. A negative government only requires courage and consistency in its officials; but a positive government requires a constant supply of invention and suggestions." [1] Administrators function in a political context; they cannot escape, and indeed to a considerable degree they must reflect, the confusions, uncertainties, and conflicts of the environment in which they operate. Yet an able and responsible public service which commands widespread public confidence can contribute to easing tensions, facilitating accommodations, and building community of purpose among conflicting groups. As the legislation of the postdepression decade passes from the stage of enactment to execution, the extent to which it wins lasting acceptance and commands widespread support will depend in no small degree upon the administrative wisdom with which it is translated into the daily habits of the community.

3. The Impact of World War II

With the opening of hostilities in Europe in the fall of 1939, powerful new forces were set in motion which threatened new strains upon the machinery of administration and drastic modifications, at least for a time, in the developing pattern of American public economic policy. For the first six months of the war, the leisurely pace of the fighting and the apparent stalemate between the leading contenders gave rise to widely held expectations that the United States might remain aloof from the struggle, gradually strengthening its own defenses and adapting itself to inevitable but relatively minor alterations in its foreign trade. Such expectations were rudely shattered by the German conquest of all northwestern Europe during the spring of 1940, by the surrender of France in June, by the heavy bombing of British industrial areas during the summer, and by the serious losses in British shipping which continued throughout the second half of 1940 and into 1941.

[1] Quoted in Felix Frankfurter, *Law and Politics* (1939), p. 240.

The needs of national defense suddenly sprang into the forefront of public policy. On May 16, 1940, President Roosevelt made the first of a series of proposals to Congress which called for an enormous immediate acceleration of military and naval construction and looked ultimately toward a two-ocean navy, a trained army numbered in the millions, and an air force of 50,000 first-line planes. In addition to the unprecedented increase in our own defenses the nation adopted a policy of "all aid to Britain short of war," dramatically symbolized in late August by the transfer to the British fleet of fifty overage American destroyers in return for a series of naval and air bases in Western Hemisphere British possessions. Early in March, 1941, Congress enacted the so-called "lend-lease" bill for aid to "the government of any country whose defense the President deems vital to the defense of the United States." Thus the United States was to become "an arsenal of democracy." In terms of their effect upon the domestic economy, the combined demands of increased American armed strength and of utmost aid to Britain promised to be little if any less far-reaching than would active participation in hostilities.

Under modern conditions of warfare, mobilization for national defense ramifies into every region of economic life. War materials must be produced on a scale far exceeding peacetime output. This task may be achieved in limited degree through improved utilization of existing industrial capacity; for the most part, however, resources must be transferred from ordinary channels of civilian consumption. As large a share as possible of the national energies—capital, labor, and skills of every variety—must be diverted from normal occupations into the objectives of military preparation. The strands of the economic fabric are so closely interwoven that control mechanisms designed to bring about industrial mobilization must perforce extend to almost every sector of the economy. Experience of the belligerents in both the first World War and the present conflict indicates that co-ordinated government controls, virtually all-embracing in extent, must be imposed in order to evoke the maximum war effort and minimize the inevitable dislocations consequent upon the shift to a war footing.

The principal areas of industrial mobilization policy, in a full-fledged war economy, fall into four classes: capital equipment and associated public utility services; materials for war production; labor; and finance. The small reserve of industrial plant engaged

in the peacetime manufacture of implements of war must suddenly be expanded manyfold. The ordinary machinery of government purchase through competitive bidding does not suffice for this purpose. Arrangements must be made for the financing of new plant which may become useless after the emergency has passed. Existing capacity devoted to peacetime production, such as automobile manufacturing, may be converted into the production of tanks and airplanes. New and unprecedented demands are imposed upon equipment for the manufacture of industrial plant—above all upon machine tools. A balance must be struck between the diversion of existing capacity into war uses and the construction of new capacity. Full use of plant for war needs must be assured, if necessary by government commandeering. At the same time, construction of new civilian plant, or even ordinary replacements, may be prevented by restricting the supply of credit or by forbidding the use of necessary materials.

Industrial plant must be supplemented by adequate utility services. Electric power must be provided. New demands are thrust upon the system of transportation. In areas of intensive war production, workers must be supplied with housing facilities and associated services. The location of war industries must be selected in the light of a host of interrelated considerations.

Difficult problems arise in connection with the need to control the flow of raw materials. War industries must be assured of steady supplies, regardless of peacetime patterns of production, distribution, and consumption. Here, too, a balance must be found between diversion from normal uses and expansion of extractive or manufacturing capacity. Where the industry supplying a particular commodity has operated below full capacity in the premobilization period, little or no special control machinery may be required. But where potential demand exceeds capacity, it may become necessary to impose priorities, forcing the scarce materials into wartime channels before civilian requirements are filled. In extreme cases, a system of priorities may even be imposed as among the various military needs themselves. The power of government to commandeer materials may be brought into operation. The limited supplies remaining for civilian use may be distributed by a system of rationing, particularly where they are essential items of general consumption. The use of substitutes may be stimulated. In order to prevent profiteering on scarce materials, extensive price-control machinery

may prove essential. The effect of war on foreign trade may require further drastic alteration in the normal flow of commodities. Import and export control may become an important weapon of indirect warfare.

Maximum war effort necessitates the fullest utilization and most effective distribution of man power no less than of industrial plant. If a conscript army is being recruited, steps must be taken to prevent the withdrawal of trained men from essential operations. Extensive training programs may be required to provide an adequate supply of special skills. Migration of labor and diversion into war industries must be facilitated.

Industrial relations in wartime present peculiarly complex problems. The relative shortage of man power and the imperative demands of production greatly strengthen the bargaining power of labor. Increased price levels may depress real wages and create industrial unrest. The line between justified wage demands and efforts on the part of labor to profit by the emergency is not easily drawn. At the same time, some employers may take advantage of the emergency to discourage organization by charging union leaders with "obstructionist tactics" or by attributing justified demands to unpatriotic motives. Since long-continued strikes or lockouts may threaten serious injury to the war program, the government interest in prevention or rapid settlement of labor disputes is far greater than in peacetime. Conciliation and mediation services are expanded. Efforts are made to secure voluntary acceptance of arbitration. Compulsion is avoided as far as possible, as it may seriously undermine morale. In cases of extreme urgency, however, the ultimate power may be brought into play, either in the mild form of compulsory arbitration, or more harshly by the drafting of labor—by the insistence that men "work or fight."

The role of war finance is secondary to that of mobilization of men and materials. Wars are not fought with dollars. Nonetheless, the methods of financing play an important role, since they determine the distribution of costs among the various sections of the nation and may materially assist or retard the physical war effort. The enormous increase in public expenditure places unparalleled demands upon fiscal policy. Taxation and borrowing must be geared into the programs of control for the flow of commodities and of capital. The tax devices of wartime may be employed with a view as much to their effects upon the workings of the economy as to their

yield to the Treasury. Profiteering may be curbed by excess profits taxation. Wartime fiscal policy may induce or discourage inflation, and will markedly affect the problems of postwar readjustment.

With the termination of the emergency, government is faced with a task of demobilization comparable in complexity to that of mobilization. The sudden stoppage in newly established channels of production and distribution, the release of men from defense industries and the armed services, the task of reconversion to peacetime uses, will all require the maintenance for a time of emergency government controls. Industries adjusted to full-speed operation with assured demand must again seek the less certain markets of civilian consumption. Cartelization under government sponsorship must give way in large measure to competition. Some portions of the emergency control machinery may be sloughed off quite readily; other portions will leave an indelible mark upon the interrelations of government and economic life.

During our participation in the first World War, the all-embracing needs of an industrial mobilization program were only gradually recognized. Machinery of control was devised by a haphazard process of trial and error. Despite the supply of war materials to the Allies on a large scale between 1915 and 1917, our economy was not geared to full war production until twelve or fifteen months after our acceptance of active belligerent status. The Civil War experience had foreshadowed the needs of economic mobilization, but only under the stress of the unprecedented demand of 1914–18 for men and matériel did the concept of total organization for war win universal acceptance.

President Wilson began the elaboration of emergency administrative machinery in 1916 through the creation of a Cabinet Council of National Defense. This body was composed of the Secretaries of War, Navy, Interior, Agriculture, Commerce, and Labor. Attached to the Council was an Advisory Commission of seven members, including five business executives charged with supervision of industrial organization and transportation, a leading surgeon to deal with medical problems, and the president of the American Federation of Labor. Each member established a separate committee and administrative staff, and from these committees there ultimately emerged the final pattern of wartime organization.

In its original conception, the Defense Commission was viewed as a liaison agency to effect systematic co-operation on a voluntary

basis between the army and navy, on the one hand, and the nation's industrialists and workers, on the other. With our active participation in hostilities, however, the need for more authoritative controls was manifested in successive areas of the economy. Legislation enacted in 1916 and 1917 provided ample reserve powers of compulsion—commandeering, priorities, licensing, and price fixing—but the government postponed their use as long as possible. Positive administrative controls were first employed in single areas. A Shipping Board was created in 1916. Food and Fuel Administrators were appointed in the summer of 1917. Later in the same year a War Trade Board was established to control foreign trade, and in December the railroad system was taken over by the government and placed under a single Director-General. In 1918 the mobilization of labor and capital was facilitated through the creation of the United States Employment Service, the War Finance Corporation, and the Capital Issues Committee. Efforts to stabilize industrial relations were made through a War Labor Board and an associated War Labor Policies Board.

Until the spring of 1918, however, the emergency machinery remained un-co-ordinated. Production and transportation were seriously hampered by overlapping authority and ill-defined responsibility. Informed observers became increasingly concerned with delays or even breakdowns in vital sectors of the war economy. President Wilson was ultimately converted to the view that full authority must be concentrated in a single agency directly under his control. To this end the War Industries Board, which had grown out of the raw materials committee of the Defense Commission, was reconstituted as the effective co-ordinating agency for the entire program. Its Chairman, Bernard M. Baruch, became the active director of economic mobilization, subject only to limited control by the other Board members and by the President. Through the War Industries Board, it has been said, the nation adopted "a system of concentration of commerce, industry, and all the powers of government that was without compare among all the other nations, friend or enemy, involved in the World War." [2]

With the ending of hostilities, the emergency machinery was demobilized as rapidly as possible. Some voices were raised in a plea that controls be maintained at least long enough to ease the transition to peacetime operations. In a few areas government

[2] Grosvenor B. Clarkson, *Industrial America in the World War* (1924), p. 63.

supervision remained for a number of years, and in others the emergency machinery was revived to care for temporary maladjustments. Thus, maximum price fixing and priorities were resumed in the bituminous coal industry in 1919–20 and 1922. The War Finance Corporation was employed during the same period to bolster up the weakened agricultural credit structure. For the most part, however, the reaction against government control after 1920 resulted in almost immediate disbanding of the wartime administrative organizations.

Postwar demobilization did not mean the complete cessation of interest in the problems of economic planning for war. The army and navy, civilians who had participated in the wartime program, and organizations like the American Legion continued to give attention to the needs of rapid and efficient organization in the event of another conflict. A Planning Branch was set up in the War Department under the Assistant Secretary; an Army Industrial College was created to train officers in the needs of industrial mobilization; and an Army and Navy Munitions Board was established to co-ordinate procurement between the two services.

In 1930 a War Policies Commission was established, composed of executive officials and members of Congress, to consider appropriate legal and constitutional measures required for industrial mobilization. The Commission brought to public attention the "Industrial Mobilization Plan" which had been evolved by the army's Planning Branch, and subjected the Plan to critical scrutiny. As international relations deteriorated during the decade of the thirties, increasingly intense interest was manifested in war planning. The army's Plan was subjected to continuing revision and was published in its developing forms in 1931, 1933, 1936, and 1939.

The Industrial Mobilization Plan, based in large part upon World War experience, was designed to come into effect on "M-Day," the date of entrance of the United States into war. In its later versions the Plan became a relatively brief and highly generalized document, merely sketching the essential emergency control machinery. Under the Plan, major authority was concentrated in a War Resources Administration controlled by a single responsible Administrator and staffed with civilians drawn "from the patriotic business leaders of the nation." Thus, the position achieved at the end of the first World War by the War Industries Board and its chairman would be duplicated at once in the event of a new war. Ap-

propriate functional subdivisions would deal with the principal sectors of the economy in co-operation with War Service Committees recruited from appropriate business groups. Separate liaison divisions would be established to deal with the problems of war labor, war trade, war finance, and price control.

Publication of the Industrial Mobilization Plan, particularly in its more elaborate earlier forms, created fears in some circles of an "industrial autocracy" which might be wholly uncontrolled by the more responsible agencies of government. The Plan, moreover, was posited on an assumption of immediate transition from peace to war; it did not envisage the possibility of a more gradual industrial mobilization without participation in actual hostilites. No provision was made for prewar, partial mobilization. The impact of the second World War upon the United States, however, was made felt in this gradual, partial fashion. Emergency administrative devices to accelerate American defense and to provide assistance to Great Britain were consequently not patterned, at least in the first instance, upon the army's Plan.

In August, 1939, with the European crisis coming rapidly to a head, the President appointed a War Resources Board of seven members which seemed to foreshadow possible application of the Industrial Mobilization Plan. The predominantly conservative composition of the Board and the absence of labor representation aroused concern in liberal circles. The Board's brief life was terminated within two months and its report never made public.

Further efforts to establish emergency agencies were temporarily abandoned during the six months of inactive warfare in Europe. In the spring of 1940, however, when German victories led to plans for the expansion of American defense on an unprecedented scale, new administrative machinery was created to carry out the program. Late in May, acting under the National Defense Act of 1916, the President revived Wilson's device of the Advisory Commission to the Council of National Defense. A seven-man board was established with each Commissioner responsible for one of the following fields: industrial production, industrial materials, employment, farm production, transportation, price stabilization, and consumer production. The Commission operated without a chairman. Liaison was maintained with the White House through the Commission's Secretary, who was also an Administrative Assistant to the President. Each Commissioner selected a staff of his own; in addition,

staff divisions were set up to serve the Commission as a whole in the fields of research and statistics, defense purchasing, defense housing, and state and local co-operation. Although the legal status of the Commission was purely advisory, it served in fact as a department of supply, co-operating with and acting for the army and navy in the negotiation of defense contracts and the procurement of necessary materials and labor. Ordinary agencies of the government were also entrusted with important duties in connection with national defense.

As the defense program acquired momentum during the summer and autumn of 1940, it was faced with difficulties not unlike those experienced in 1917. Serious delays were encountered in securing necessary expansion of plant. Far-reaching differences of opinion arose concerning the most appropriate means of achieving an immediate acceleration in the output of airplanes. Although the President declared in general terms the Administration's intention to maintain intact its domestic reforms of the previous eight years, powerful pressures were brought to bear in an effort to modify existing policy in antitrust law enforcement, labor relations, and other areas. It was widely felt that more effective co-ordination, under the close supervision of a single responsible agency, was essential.

In January, 1941, therefore, there was superimposed upon the Defense Commission an Office of Production Management for Defense. The Office consisted of a Director-General and an Associate Director-General, the Secretary of War, and the Secretary of the Navy. William S. Knudsen and Sidney Hillman, previously Defense Commission members for industrial production and employment, respectively, were appointed to the chief positions. The Office was made directly responsible to the President. It was given broad authority, in the following terms, to:

> a. Formulate and execute in the public interest all measures needful and appropriate in order (1) to increase, accelerate, and regulate the production and supply of materials, articles and equipment and the provision of emergency plant facilities and services required for the national defense, and (2) to insure effective co-ordination of those activities of the several departments, corporations, and other agencies of the Government which are directly concerned therewith.
>
> b. Survey, analyze, and summarize for purposes of co-ordination the stated requirements of the War and Navy and other departments and

agencies of the Government, and of foreign governments for materials, articles, and equipment needed for defense.

c. Advise with respect to the plans and schedules of the various departments and agencies for the purchase of materials, articles, and equipment required for defense, to co-ordinate the placement of major defense orders and contracts and to keep informed of the progress of the various programs of production and supply.

d. Plan and take all lawful steps necessary to assure the provision of an adequate supply of raw materials essential to the production of finished products needed for defense.

e. Formulate plans for the mobilization for defense of the production facilities of the Nation, and to take all lawful action necessary to carry out such plans.

f. Determine the adequacy of existing production facilities and to assure their maximum use; and, when necessary, to stimulate and plan the creation of such additional facilities and sources of production and supply as may be essential to increase and expedite defense production.

g. Determine when, to what extent, and in what manner priorities shall be accorded to deliveries of material. . . . Deliveries of material shall take priority, as provided in said Act, in accordance with such determinations and the orders issued in pursuance thereof by the Office of Production Management.

h. Perform the functions and exercise the authorities vested in the President by Section 9 of the Selective Training and Service Act of 1940 [requiring obligatory compliance by manufacturers with orders for material needed for defense purposes]. . . .

i. Serve as the liaison and channel of communication between the Advisory Commission to the Council of National Defense and the Departments of War and Navy with respect to the duties imposed upon the Commission. . . .

j. Perform such other functions as the President may from time to time assign or delegate to it.

Meanwhile, a stream of defense measures was passed by Congress which, taken as a whole, constituted the framework for a complete system of industrial mobilization. Military conscription, patterned after the general model of 1917, was adopted in September, 1940. Where authority for commandeering, priorities, and price control had not been retained from World War legislation, new legislative provisions were enacted. The Reconstruction Finance Corporation was given full authority to finance plant expansion and other emergency activities and, where necessary, to create corporations to engage directly in defense production. Provisions were made for the

financing of government-owned facilities in private plants. The limit on the national debt was raised to permit extensive new borrowing; taxation was somewhat increased to provide new revenue; and a moderate Excess Profits Tax Act was placed in operation.

In accordance with its announced policy, the Office of Production Management relied as far as possible upon voluntary co-operation for the achievement of its objectives. During the winter of 1940–41, however, it was found necessary to impose "price ceilings" upon secondhand machine tools and aluminum scrap, and to establish priorities for machine tools, aluminum, synthetic rubber, magnesium, and other scarce commodities vital to the defense program. Proposals were under consideration for the creation of new mediation machinery to assist in the settlement of labor disputes in defense industries.

By March, 1941, the United States was still far from a state of total industrial mobilization. The budget for the fiscal year 1941–42 envisaged defense expenditures of almost $11,000,000,000. Aid to Great Britain and her allies was estimated to call at least for a further $5,000,000,000. Thus about one fifth of our national income was earmarked for defense purposes. In the belligerent nations the proportion had become as high as one half. But the currents of public policy were flowing ever more rapidly toward total economic mobilization. On March 15, the President gave expression to this policy in no uncertain terms:

> A half-hearted effort on our part will lead to failure. This is no part-time job. The concepts of "business as usual" and "normalcy" must be forgotten until the task is finished. This is an all-out effort—nothing short of all-out effort will win.
>
> We are now dedicated, from here on, to a constantly increasing tempo of production—a production greater than we now know or have ever known before—a production that does not stop and should not pause.

4. Emergency Controls in a Constitutional Democracy

The demands of economic mobilization posed problems of control surpassing in magnitude anything heretofore experienced in our national history. Its consequences for American public policy were intimately dependent upon the duration and outcome of the armed conflict abroad and upon the possibilities of our active involvement in hostilities. Whatever the outcome, ultimate demobilization was

certain to bring in its train serious problems of readjustment, which would tax the ingenuity both of government and of leaders in all sectors of the economy.

Meanwhile, the consolidation of emergency controls did not signify the abandonment of fundamental democratic liberties. The stringent controls imposed in an emergency period through constitutional processes were not to be confused with the pattern of totalitarian dictatorship. Policy was being vigorously debated. The transcendent necessities of national defense called for sacrifices from all groups, but they were accepted almost universally in a spirit of collaborative recognition of emergency needs rather than of compulsion from above. These sacrifices did not signify any permanent subjection of individuals and freely organized groups to an omnipotent state. Persisting into the emergency was a vigorous and continuing faith in democratic processes, which was fed and sustained by a long tradition. That faith gave assurance that, however complex the economic problems of the future, solutions would be sought in keeping with the traditional values of a democratic political order.

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